Supreme Court, U.S.
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No. _____

In the
Supreme Court of the United States
October Term, 1996

KIRK DAHL, *et al.*, on behalf of themselves and all others similarly situated,

Petitioners,

v.

CHARLES SCHWAB & CO., INC.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE MINNESOTA SUPREME COURT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Did Congress intend federal securities law to pre-empt state law as it applies to a broker-dealer's receipt and retention of order flow cash kickbacks from wholesale securities dealers?

PARTIES TO THE PROCEEDING

Petitioners are Kirk Dahl, Robert Olson and Charles Dahl (no relation to Kirk Dahl), individual securities investors who reside in the State of Minnesota. Petitioners sought to represent a class of Minnesota residents who purchased or sold securities through respondent Charles Schwab & Co., Inc. in which Schwab received from market makers or wholesale securities dealers a cash kickback known as "payment for order flow." Petitioners shall refer to respondent as "Schwab" in this Petition.

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KIRK DAHL, *et al.*, on behalf of themselves and all other similarly situated,

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CHARLES SCHWAB & CO., INC.,

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PETITION FOR WRIT OF CERTIORARI TO THE MINNESOTA SUPREME COURT

Petitioners Kirk Dahl, Robert Olson and Charles Dahl respectfully petition this Court for a Writ of Certiorari to review the decision of the Minnesota Supreme Court in this case.

OPINIONS BELOW

The Minnesota Supreme Court's decision that federal securities law pre-empts Minnesota common and statutory law is reported as *Dahl v. Charles Schwab & Co.*, 545 N.W.2d 918 (Minn. 1996), and is reproduced in the Appendix to this

Petition for Writ of Certiorari ("Pet. App.") at 1a - 19a. The Minnesota Court of Appeals' decision finding no pre-emption is reported as *Dahl v. Charles Schwab & Co.*, 524 N.W.2d 742 (Minn. Ct. App. 1994) (Pet. App. 20a - 33a). The state district court's Order and Memorandum dismissing the complaints on pre-emption grounds is not reported. (Pet. App. 34a - 40a).

JURISDICTION

The Minnesota Supreme Court filed its opinion and entered judgment on April 19, 1996. (Pet. App. 1a.) This timely Petition for Writ of Certiorari is filed pursuant to Supreme Court Rule 13. This Court has jurisdiction pursuant to 28 U.S.C. § 1257(a).

28 U.S.C. § 2403(b) may apply because this case involves the constitutionality of Minnesota Statutes. Therefore, petitioners have, pursuant to Supreme Court Rule 29.4(c), served a copy of this Petition on the Minnesota Attorney General.

STATUTES AND REGULATIONS INVOLVED

This Petition for Writ of Certiorari raises the question whether the pre-emption clause of the 1934 Securities Exchange Act and the regulations of the Securities and Exchange Commission pre-empt state common law and statutory remedies available to investors. The following statutes and regulations are involved:

I. FEDERAL CONSTITUTIONAL PROVISION.

The Supremacy Clause, U.S. Const. art. VI, cl. 2, provides:

This Constitution, and the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges of every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

II. FEDERAL SECURITIES LAW, 15 U.S.C. § 78bb (1992).

The pre-emption provision of the Securities Exchange Act of 1934, Section 28, (15 U.S.C. § 78bb) in relevant part reads:

78bb. Effect on existing law

Addition of rights and remedies; recovery of actual damages; State securities commissions

(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity;

* * *

Exchange, broker, and dealer commission; brokerage and research services

(e)(1) No person using the mails, or any means or instrumentality of interstate commerce, in the exercise of investment discretion with respect to an account shall be deemed to have acted unlawfully or to have breached a fiduciary duty under State or Federal law unless expressly provided to the contrary by a law enacted by the Congress or any State subsequent to June 4, 1975, solely by reason of his having caused the account to pay a member of an

exchange, broker, or dealer an amount of commission for effecting a securities transaction in excess of the amount of commission another member of an exchange, broker, or dealer would have charged for effecting that transaction, if such person determined in good faith that such amount of commission was reasonable in relation to the value of the brokerage and research services provided by such member, broker, or dealer, viewed in terms of either that particular transaction or his overall responsibilities with respect to the accounts as to which he exercises investment discretion.

III. RULES OF THE SECURITIES AND EXCHANGE COMMISSION, 17 C.F.R. § 240.10b-10 (PROMULGATED 1977).

§ 240.10b-10 Confirmation of transactions.

(a) It shall be unlawful for any broker or dealer to effect for or with the account of a customer any transaction in, or to induce the purchase or sale by such customer of, any security (other than U.S. Savings Bonds or municipal securities) unless such broker or dealer, at or before completion of such transaction gives or sends to such customer written notification disclosing--

* * *

(7) If he is acting as an agent for such customer, for some other person, or for both such customer and some other person,

* * *

(iii) The source and amount of any other remuneration received or to be received by him in connection with the transaction; Provided, however, That if, in the case of a purchase, the broker was not participating in a distribution, or in the case of a sale, was not participating in a tender offer, written notification may state whether any other remuneration has been or will be received and that the source and amount of such other remuneration will be furnished upon written request of such customer.

IV. MINNESOTA STATUTORY PROVISIONS.

A. Minnesota Uniform Deceptive Trade Practices Act, Minn. Stat. § 325F.69 (1992).

Minn. Stat. § 325F.69. Unlawful practices

Subdivision 1. Fraud, misrepresentation, deceptive practices. The act, use, or employment by any person of any fraud, pretense, false promise, misrepresentation, misleading statement or deceptive practice, with the intent that others rely thereon in connection with the sale of any merchandise, whether or not any person has in fact been mislead, deceived, or damaged thereby, is enjoined as provided herein.

B. Prevention of Consumer Fraud Act, Minn. Stat. § 325D.44 (1992).

Minn. Stat. § 325D.44. Deceptive trade practices

Subdivision 1. A person engages in a deceptive trade practice when, in the course of business, vocation, or occupation, the person:

* * *

(13) engages in any other conduct which similarly creates a likelihood of confusion or of misunderstanding.

C. Minnesota Blue Sky Securities Statute, Minn. Stat. § 80A.06 (1992).

Minn. Stat. § 80A.06, subd. 5.

No investment adviser who shall recommend the purchase or sale of a security to a client, and no licensed broker-dealer acting as a broker-dealer for a customer in the purchase or sale of a security shall take or accept any remuneration or other thing of value from any person other than the client or customer in connection with the purchase or sale unless, prior to or contemporaneously with the confirmation of the transaction in the case of a licensed broker-dealer so acting, written disclosure to the client or customer is made of the acceptance or intended acceptance of the remuneration or other thing of value and of the amount of it.

* * *

STATEMENT OF THE CASE

I. FACTS AND THE HISTORY OF PAYMENT FOR ORDER FLOW.

The heart of this action is Schwab's practice of routing its clients' orders to certain wholesale dealers who pay Schwab cash kickbacks in exchange for their business. Euphemistically termed "order flow inducements," Schwab neither passes the kickback along to its principal, the investor, nor does it adequately disclose the practice or obtain its clients' consent before keeping the profits. Schwab does not deny that it receives and retains the kickbacks.

A. The Kickback Scheme.

Wholesale securities dealers make money by executing buy and sell orders for retail brokers like Schwab. The difference between the bid price and the ask price constitutes the wholesale dealer's spread, which is measured in eighths of a dollar. Dealers will kick back a certain amount of cash per share or per trade to "induce" retail brokers into steering business their way. The specialist or dealer will usually pay a few cents per share back to a broker in exchange for the broker's business. These kickbacks, or cash "payments for order flow," have become a significant source of income, especially to discount brokers such as Schwab whose declared commission may be only a few cents per share. Schwab does not disclose this practice and does not pass the kickbacks on to its customers.

B. The Absence of Federal Regulation of Order Flow Kickbacks.

1. Congress.

Congress has passed *no* statute regarding the payment or receipt of cash order flow kickbacks. It has, however, carefully defined the pre-emptive reach of the federal securities laws. When Congress enacted the Securities Exchange Act in 1934, it expressly reserved for the states the right to regulate the securities markets concurrently with federal law. In Section 28(a) of the Exchange Act, 15 U.S.C. § 78bb(a), Congress mandated:

> The rights and remedies provided by this title *shall be in addition to any and all other rights and remedies* that may exist at law or in equity.

(Emphasis added).[1]

In 1975, Congress amended the Exchange Act, including Section 28, wherein Congress added Sections 28(d) and 28(e). Pub. L. No. 94-29, § 21, 89 Stat. 160 (1975). These amendments expressly and precisely pre-empt certain state

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[1] States' blue sky laws predate Congress' securities law enactments in 1933 and 1934. 1 Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation* 58 (3d ed. 1989). In specifically discussing disclosure requirements, the authors of this treatise stated "it cannot be assumed that Congress would have been satisfied with the relatively mild disclosure philosophy in 1933 if the blue sky laws had not been on the books." Furthermore, "[t]he state blue sky laws have become so much a part of the scheme of things that their displacement after over 50 years of dual regulation, when Congress did not see fit to get rid of them in the 'hundred days' of 1933, seems hardly more likely than repeal of the income tax." *Id.* Thus, the states and federal governments have long concurrently regulated securities; Congress has expressly preserved states' rights in this area.

laws in a pointedly limited way. First, Congress pre-empted any attempt by a state to tax securities or the transfer of securities solely because an exchange or transfer agent happens to be physically located in the taxing state. Exchange Act § 28(d), 15 U.S.C. § 78bb(d).[2]

Second, Congress expressly pre-empted any state or federal law, existing on June 4, 1975, which would have made it a *per se* violation of fiduciary duty for a money manager controlling a discretionary account to fail to place an order with the least expensive broker dealer. Exchange Act § 28(e), 15 U.S.C. § 78bb(e). The purpose of this express pre-emption provision was to allow money managers who have discretionary investment authority to place orders with broker-dealers who provide "soft dollar" services, such as investment research, even if that broker-dealer charges higher commissions, if that was in the best interest of the investor.[3] Senate Comm. on Banking, Housing & Urban Affairs, Securities Acts Amendments of 1975, S. Doc. No. 94-75, 94th Cong., 1st Sess. 70 (1975) ("1975 Senate Report"). Congress expressly limited the scope of this pre-emption clause, however. Even after the 1975 amendments, states could enact laws which would make it a fiduciary breach if the adviser failed to seek the lowest possible commission when placing

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[2] This amendment was targeted primarily at New York, the home of the New York Stock Exchange. S. Rep. No. 75, 94th Cong., 1st Sess. 60, *reprinted in* 1975 U.S. Code Cong. & Admin. News 179, 238. Congress intended subsection (d) "to work the least possible interference with State law while at the same time facilitating the purposes of the bill." *Id.* at 139, 1975 U.S. Code Cong. & Admin. News at 316.

[3] Examples of special services, or soft dollars from a member to a nonmember include installation and maintenance of wire services, clearance of non-Exchange transactions, office space, research, and promotional materials and displays. Report of Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963) ("SEC Special Study") at 308.

buy and sell orders. In other words, Congress intentionally limited the pre-emption of state laws concerning soft dollar order flow inducements to pre-existing common law and statutes.

Both of these express pre-emption clauses evidence Congress' ongoing commitment to dual state and federal securities regulation. Section 78bb(e) is especially relevant to this case because it concerns soft dollar inducements for order flow, a practice that raises similar fiduciary concerns to cash inducements.[4] Payment for Order Flow, Exchange Act Release No. 34902 [1994-95 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,444 (Oct. 27, 1994). Congress has considered the fiduciary ramifications of inducements for order flow and has expressly chosen *not* to pre-empt any attempt by states to regulate in this area, except for the limited provision at 15 U.S.C. § 78bb(e).

2. The Securities and Exchange Commission.

The rules of the SEC, too, have historically overlooked order flow kickbacks. At the time petitioners filed their complaints, the only federal regulation that even touched on the practice was Rule 10b-10(a)(7)(iii), 17 C.F.R. § 240.10b-10(a)(7)(iii).[5] Rule 10b-10 is a catch-all provision. As it was

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[4] In commenting on this Section 28(e), the SEC stated: "[ordinarily, a fiduciary that uses the assets of its managed accounts for its own benefit would be subject to claims of a breach of fiduciary duty under *state and federal law*." U.S. Equity Market Structure Study, Exchange Act Release No. 30920 [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,012 (July 14, 1992) (A-127 n.7) (emphasis added).

[5] In 1994, the SEC amended Rule 10b-10, effective October 2, 1995. Payment for Order Flow, Exchange Act Release No. 34902 [1994-95 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,444 (Oct. 27, 1994). In the amended Rule 10b-10, the SEC expressly defined "payment for order flow" for the first time and requires certain disclosures by all retail

enforced, the Rule required only that a broker-dealer send its client written notification disclosing "whether *any other remuneration* has been or will be received and that the source and amount of such other remuneration will be furnished upon written request of such customer." *Id.* (Emphasis added). When the SEC announced its creation of Rule 10b-10 in 1977, it explained that "[t]he rule does not attempt to set forth all possible categories of material information to be disclosed by broker-dealers in connection with a particular transaction in securities." Securities Confirmations--Delivery & Disclosure Requirements, Exchange Act Release No. 13508 [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,143 (May 5, 1977). In that 1977 release, the SEC described only one example of other remuneration: the commission paid by the opposite side of a transaction where the broker-dealer is acting in a dual agency role. *Id.* The Rule does not mention inducements or kickbacks for order flow, but it is commonly agreed that such kickbacks constitute "other remuneration" for purposes of the Rule. *See, e.g.*, NASD Notice to Members No. 85-32 (Apr. 30, 1985).

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broker-dealers who receive such payments on their clients' behalf on or after October 3, 1995.

The SEC at the same time also promulgated the new Rule 11Ac1-3, 17 C.F.R. § 240.11Ac1-3, which requires broker-dealers to inform their clients "in writing, upon opening a new account and on an annual basis thereafter," of their policies regarding payment for order flow, including "a detailed description of the nature of the compensation received" and "policies for determining where to route customer orders that are the subject of payment for order flow." *Id.* The new rules therefore, require Schwab to disclose its kickback practices *before* its client places an order, contrary to its historic practice.

The Minnesota Supreme Court recognized that the amended and new rules are irrelevant to the pre-emption issue in these proceedings. *Dahl v. Charles Schwab & Co.*, 545 N.W.2d 918, 922 (Minn. 1996).

The SEC has repeatedly stated that state agency laws *do* apply to order-flow inducements. In 1992, it noted that "a fiduciary that uses the assets of its managed accounts for its own benefit would be subject to claims of a breach of fiduciary duty under *state and federal law*." SEC Release No. 34-30920, July 14, 1992 (emphasis added). In 1993, the SEC, acknowledging the concern that order flow kickbacks may violate state agency law, asked for "analyses of any state statutes that commentators believe apply or may apply to the payment for order flow practices." Release No. 33026.

In the 1963 SEC Special Study, the SEC remarked on the pivotal role the States play in securities regulation and shows the federal law does not preempt state law in this context:

> *There has not been and should not be Federal preemption in the field of securities regulation. State "blue sky" laws antedate Federal regulation, and both the Securities Act and the Exchange Act specifically provide that nothing therein shall affect the jurisdiction of any State regulatory agency.* * * * State regulation not only provides investor protection where the intrastate or other exemptions of the Securities Act precludes Federal regulations, but *also provides a second line of protection where Federal law is applicable.*

SEC Special Study. Pt. IV at 734 (emphasis added). Historically, the SEC has acknowledged that broker-dealers have special fiduciary "obligations to deal fairly with the members of the public," obligations "imposed both by Federal and State laws relating to the sale of securities." SEC Special Study, Pt. II at 237-38. Thus, neither Congress nor the SEC, in 1933, 1963, 1975, 1978 or 1993 has seen fit to pre-empt states law except in exceptionally limited circumstances. *See* 15 U.S.C. § 78bb.

II. MINNESOTA COURT PROCEEDINGS.

A. The Class Action Complaints and District Court Proceedings.

Petitioners Kirk Dahl, Robert Olson, and Charles Dahl, on behalf of themselves individually and all other similarly situated, each commenced actions in Hennepin County District Court against Schwab. Petitioners' complaints asserted five causes of action under Minnesota common and statutory law: (1) breach of fiduciary duty for Schwab's failure to disclose its receipt of order flow kickbacks; (2) breach of fiduciary duty to avoid self dealing for Schwab's receipt of order flow kickbacks while acting as agent for its customers; (3) money had and received; (4) violation of Minnesota Uniform Deceptive Trade Practices Act, Minn. Stat. § 325D.43 - .48 (1992); and (5) violation of Minnesota Consumer Protection Statute, Minn. Stat. § 325F.68 - .70 (1992). Petitioners sought damages, an accounting of Schwab's profits and injunctive relief.

Before filing an answer, Schwab moved to dismiss the complaints on the basis of federal pre-emption. The district court granted summary judgment in favor of Schwab on April 7, 1994, and dismissed the complaints. (Pet. App. 35a.) The district court concluded that application of state law to order flow kickbacks violates the Supremacy Clause of the United States Constitution. (Pet. App. 37a - 38a.)

B. The Minnesota Court of Appeals Held Federal Securities Law Does Not Pre-empt State Common and Statutory Law.

The Minnesota Court of Appeals reversed and remanded. *Dahl v. Charles Schwab & Co.*, 524 N.W.2d 743 (Minn. Ct.

App. 1994) (Pet. App. 20a). In reversing, the court of appeals determined that federal law did not pre-empt state law because compliance with both Minnesota and federal law was not impossible:

> In the present case, compliance with both state law, if applicable, and the SEC rule is not an impossibility. *Compliance with Minn. Stat. § 80A.06, subd. 5 necessarily satisfies SEC Rule 10b-10(a)(7)(iii). Thus, the laws are not conflicting.* Moreover, *the state legislature should be able to enact stricter laws protecting its citizens than federal laws, unless there is some overriding federal or national consideration.*
>
> In addition to their statutory claims, [petitioners] allege common law causes of action based primarily on Minnesota agency law. [Petitioners] assert that Schwab, as their fiduciary, owed them a duty of loyalty, a duty of full disclosure, and a duty of due care in executing their instructions. Under agency principles, [petitioners] also assert that Schwab owed a duty to divulge the amount and source of remuneration it received in exchange for routing orders to certain wholesale dealers. *Assuming [petitioners'] common law claims are actionable, there are no federal laws that conflict with or would preclude the bringing of such claims.*

Id. at 746 (emphasis added) (Pet. App. 29a - 30a). The court of appeals also concluded that federal securities law did not pre-empt state law since the Minnesota statutory and common law claims petitioners asserted did not frustrate congressional purposes and objectives:

> We reject Schwab's assertion that [petitioners] are attempting to use Minnesota law to affect the operation of the national securities markets. *A review of [petitioners'] complaints reveals that [petitioners] do not suggest that order flow payments themselves are illegal under Minnesota law or that they should be prohibited. Rather, the crux of [petitioners'] complaints is that order flow payments were retained by Schwab without any disclosure to or remuneration of Schwab's clients.*

Id. (emphasis added) (Pet. App. 30a - 31a).

C. The Minnesota Supreme Court Erroneously Held Federal Securities Law Pre-empts State Common and Statutory Law.

The Minnesota Supreme Court granted Schwab's Petition for Further Review and reversed. *Dahl v. Charles Schwab & Co.*, 545 N.W.2d 918 (Minn. 1996) (Pet. App. 1a). Despite Congress' passage of an unambiguous express pre-emption provision, 15 U.S.C. § 78bb, the Minnesota Supreme Court applied an implied pre-emption analysis. The court held that SEC Rule 10b-10(a)(7)(iii) (17 C.F.R. § 240.10b-10(a)(7)(iii))[6] impliedly pre-empts any State's attempt to protect investors from the conflict of interest inherent in order flow inducements. Rule 10b-10 does not mention order flow inducements. Rather it is a catch-all rule that requires retail securities brokers to disclose whether they receive any "non-

[6] Unless otherwise indicated, references to Rule 10b-10 will address the Rule as it has been enforced since promulgated in 1977. Although the SEC has amended the Rule, effective October 2, 1995, the Minnesota Supreme Court, as well as both lower courts that reviewed petitioners' complaint, applied their Supremacy Clause analysis to the Rule as originally drafted.

commission revenue." The Rule requires the broker to disclose the amount and source of such revenue upon the request of the investor/principal.

The court held that Minnesota's law of agency requires Schwab to remit the kickbacks to its customers or obtain their fully-informed consent to keep the kickbacks for itself. *Dahl*, 545 N.W.2d at 925 (citing *Doyen v. Bauer*, 211 Minn. 140, 300 N.W.2d 451 (1941) ("[P]rofits made in the course of the agency belong to the principal whether they are the fruits of performance or violation of the agent's duty")) (Pet. App. 17a - 18a). This, the court opined, would essentially end the practice, which federal law does not prohibit. The court thus found a conflict between SEC Rule 10b-10 and state agency law, holding that this conflict requires state law be pre-empted in favor of Congress' and the SEC's objectives of a uniformly regulated and competitive securities market.

REASONS FOR GRANTING THE WRIT

The Minnesota Supreme Court's decision threatens fundamental principles of federalism and the States' historic right to regulate their licensed securities brokers. The court concluded that the SEC pre-empted state agency law as it applies to order flow kickbacks, even though Congress expressly preserved the States' right to regulate order flow practices.

The Minnesota Supreme Court decision requires the review of this Court for three reasons. First, the decision of the lower court not only threatens the many order flow inducement actions now pending in state and federal courts throughout the country, but also undermines the historic balance of state and federal oversight in the securities industry. Second, courts have issued conflicting decisions regarding the pre-emptive effect of Rule 10b-10 as promulgated in 1977. While the Minnesota Supreme Court is the only state court of

last resort to decide the pre-emption question, the issue has been the subject of intense scrutiny and requires this Court's review. Finally, the Minnesota court ignored this Court's mandate in *Medtronic, Inc. v. Lohr*, ___ U.S. ___, 64 U.S.L.W. 4625 (June 26, 1996), *Freightliner Corp. v. Myrick*, ___ U.S. ___, 115 S. Ct. 1483 (1995) and *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504 (1992) to abide by Congress' manifest pre-emptive intent.

As an alternative to this Court's full review, petitioners ask this Court to vacate the judgment of the Minnesota Supreme Court and remand this action for further proceedings consistent with this Court's recent decision in *Medtronic*.

I. THE DECISION OF THE MINNESOTA SUPREME COURT THREATENS THE STATES' HISTORIC REGULATORY ROLE AS THE "FRONT LINE OF DEFENSE" AGAINST UNFAIR PRACTICES IN THE SECURITIES INDUSTRY.

The Minnesota court's decision will have a far reaching, and potentially profound impact on the States' power to regulate the securities industry and the broker-client relationship in particular. The court's pre-emption decision "will no doubt reach far beyond the borders of Minnesota." *Dahl*, 545 N.W.2d at 925 (Pet. App. 17a). Indeed, it is hard to reconcile the Minnesota decision with the long-standing dual regulation of the industry. In 1933, Congress looked for guidance to the Blue Sky Laws in nearly every State when it enacted the Securities Act. In Section 16 of that Act, Congress first affirmed the right of all States to exercise their historic power to police the industry. In the savings clauses found in both the 1933 Securities Act and the 1934 Securities Exchange Act,[7] Congress expressly stated its intention to

[7] In § 28(a) of the Securities Exchange Act of 1934 Congress declared: "[t]he rights and remedies provided by this chapter shall be in

preserve common law agency principles and allow States to pass and enforce securities regulations. *See Leroy v. Great W. United Corp.*, 443 U.S. 173, 182 (1979). This preservation of States' rights has been Congress' constant priority. The Minnesota Supreme Court's decision threatens the continued vitality of the right of States to regulate in the securities industry.

Rule 10b-10, as promulgated in 1977, makes no mention of order flow kickbacks. In fact, cash order flow kickback practices did not arise until *after* the SEC promulgated Rule 10b-10. If that Rule has the power to pre-empt Minnesota's law of agency, then "a variety of state [securities] laws of hitherto unquestioned validity" are at risk. *See CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 84-85 (1987). In finding a Congressional intent to pre-empt state law, the Minnesota Supreme Court stated:

> compliance with the potential consent requirements of Minnesota law might put an end to the practice of order flow payments, which is allowed under federal law. Thus, the remedy respondents seek could frustrate the objectives of the SEC and Congress . . . Congress intended the SEC to regulate the securities markets and industry to encourage competition.

Dahl, 545 N.W.2d at 925 (citations omitted) (Pet. App. 18a). In other words, the court found Congress' objective of encouraging competition to be evidence of its intent to pre-empt state agency law.

Similar reasoning would support finding pre-emption of other areas of state securities regulation. Minnesota and all of

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addition to any and all other rights and remedies that may exist at law or in equity." 15 U.S.C. § 78bb(a). Section 16 of the Securities Act contains virtually identical language. 15 U.S.C. § 77p.

the States, the District of Columbia and Puerto Rico enforce separate "Blue Sky" laws. Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation* 9 (3d ed. 1995) ("Loss"). The States routinely regulate in areas that are concurrently regulated by Congress and the SEC. Minnesota imposes licensing requirements upon its brokers under Minn. R. §§ 2875.0110 *et seq.* (1993), holds them to the standards of securities fraud under Minn. Stat. § 80A.01 *et seq.* (1992), regulates minimum capital requirements, Minn. R. § 2875.1920 (1993), and enforces its own record keeping requirements. Minn. R. §§ 2875.1500 - 1590 (1993). The other forty-nine States are free to impose on their brokers similar or utterly different requirements. Loss at 15-17. Furthermore, all fifty States enforce anti-fraud provisions that in many instances define "securities fraud" equally or even more broadly than federal law does. *See, e.g., People v. Federated Radio Corp.*, 244 N.Y. 33, 38-39, 41, 154 N.E. 655, 657-658 (1926). All of these duties are concurrently regulated under the state and federal securities laws and the regulations of the SEC. If Congress' desire to encourage competition implies an intent to tamper with the regime of dual regulation and pre-empt state law, there can be no room for such state-by-state regulation. All state securities laws that differ from federal law would be pre-empted, despite Congress' mandate to the contrary.

In June of this year, Arthur Levitt, Chair of the SEC, testified before U.S. Senate Committee on Banking, Housing and Urban Affairs that "state regulators are the front line of defense" against fraudulent and abusive practices. (Pet. App. 58a.) The *Dahl* decision gives this Court an opportunity to restore the States' to their historic and rightful place on that front line.

II. THE UNITED STATES SUPREME COURT SHOULD RESOLVE THE CONFLICT THAT HAS ARISEN AMONG COURTS THROUGHOUT THE COUNTRY.

Investors in several States have brought actions against Schwab and other brokers, alleging that the undisclosed receipt and retention of order flow kickbacks violates the broker's agency and fiduciary duties to its clients. Invariably, the broker-dealers in these actions have challenged the state law claims under the Supremacy Clause. Although the Minnesota Supreme Court is the only court of last resort to rule on the pre-emption question, at least six other state and federal courts have issued opinions regarding the effect of federal law, particularly Rule 10b-10, on the States' power to regulate the broker-client relationship. A brief review of these decisions demonstrates that the pre-emption question has become well developed, and requires this Court's review.

In two separate actions, the Appellate Division of the New York County Supreme Court denied Supremacy Clause challenges to claims alleging breach of fiduciary and statutory duty in the collection and undisclosed retention of order flow kickbacks. *Evangelist v. Fidelity Brokerage Services, Inc.*, 637 N.Y.S.2d 392 (N.Y. App. Div. 1996) (no pre-emption where state law requiring additional disclosure before retaining order flow inducements do not conflict with federal law); *Guice v. Charles Schwab & Co.*, 630 N.Y.S.2d 317 (N.Y. App. Div. 1995) (no federal law or regulation deals directly with order flow payments; no specific conflict exists between New York and federal law), *review granted*, (N.Y. 1996). A state trial court in Illinois came to the opposite conclusion, holding that Rule 10b-10 does pre-empt state law as it applies to order flow kickbacks. *Orman v. Charles Schwab & Co.*, Civ. No. 93 CH 7365 (Cook Co., IL Cir. Ct. June 2, 1994) (Pet. App. 41a.)

In *Gilman v. BHC Securities, Inc.*, [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,051 (S.D.N.Y. Dec. 18, 1995) (*Gilman I*), the court analyzed claims somewhat different from those asserted by the petitioners in this action. There, the plaintiffs alleged that New York law absolutely prohibits retail brokers from accepting cash inducements for order flow. Petitioners here, however, have alleged that Minnesota law prohibits Schwab only from collecting and retaining order flow kickbacks without first disclosing and obtaining the informed consent of its customers.

The plaintiff in *Gilman I* originally filed his action in state court. Defendant BHC Securities, Inc. removed the *Gilman I* action to the Southern District of New York, claiming diversity and federal question jurisdiction on the grounds that federal law completely pre-empts New York law. On defendant's motion to dismiss, the district court distinguished the complaint before it from those in *Dahl* and *Guice*, then held that New York law, to the extent it prohibits order flow kickbacks, conflicts with federal law which permits such practices. *Gilman I* at ¶ 94,246. The court held that federal law pre-empts New York law and dismissed the action. *Id.* at ¶ 94,247.

Another action involving the same plaintiff survived the pre-emption challenge. In *Gilman v. Wheat, First Securities, Inc.*, 896 F. Supp. 507 (D. Md. 1995) (*Gilman II*) the court remanded the action back to state court where it had been originally filed, holding that the federal securities laws have not completely pre-empted state law regulating order flow practices. *Id.* at 512. Two federal district courts in Louisiana had earlier reached the same conclusion. *Thomas v. Charles Schwab & Co.*, Civ. A. No. 95-0307 (W.D. La. July 12, 1995) (1995 WL 626522) (Pet. App. 41a) (federal securities laws do not pre-empt state agency law; additional disclosure duties under state law do not conflict with SEC Rule 10b-10); *Dumont v. Charles Schwab & Co.*, Civ. A. No. 95-0606 (E.D.

La. May 4, 1995) (1995 WL 262262) (Louisiana may require a stricter standard of care than federal law; no conflict between Louisiana and federal law, thus no pre-emption) (Pet. App. 46a). On remand to the Louisiana state district court, the judge in *Dumont* held that Louisiana agency law poses no irreconcilable conflict with federal law, particularly Rule 10b-10. *Dumont v. Charles Schwab & Co.*, No. 95-1527 (Civ. D. Ct. Of Louisiana, Orleans Parish, Div. L, June 30, 1995) (Pet. App. 55a).

This Court's guidance is necessary to resolve the unsettled pre-emption question. While the majority opinion is that federal securities laws do *not* pre-empt state agency law, the Minnesota Supreme Court in this case and the Southern District of New York in *Gilman I* have held that federal regulation of order flow practices leaves no room for contrary state law.

This Court's analysis and decision regarding the pre-emptive effect of federal securities laws on state agency law will have national significance and will affect the regime of securities regulation in all fifty States. This Petition provides the opportunity for this Court to ensure that Congress' decision not to pre-empt state law applies uniformly to state statutory and common law. This case is significant, not only as it applies to order flow inducement practices, but as it applies generally to the States' attempts to regulate the conduct and duties of their licensed securities professionals.

III. THE MINNESOTA SUPREME COURT IGNORED THIS COURT'S MANDATE THAT WHERE CONGRESS' PRE-EMPTIVE INTENT IS CLEAR, NO IMPLIED PRE-EMPTION ANALYSIS IS NECESSARY OR APPROPRIATE.

A. Where Congress has Stated its Intent to Pre-empt State Law Relating to a Specific Subject, the Language of the Mandate Dictates the Scope of the Pre-emption.

This Court has held repeatedly and consistently that courts should not find federal pre-emption of state law lightly. "It will not be presumed that a federal statute was intended to supersede the exercise of the power of the state unless there is a clear manifestation to do so. The exercise of federal supremacy is not lightly presumed." *New York State Dep't of Social Services v. Dublino*, 413 U.S. 405, 413 (1973). The bedrock assumption underlying the various pre-emption doctrines is that "the historic police powers of the States [are] not to be superseded by . . . Federal Act unless that [is] the clear and manifest purpose of Congress." *Cipollone v. Liggett Group, Inc.*, 505 U.S., at 516. Most recently, this Court noted that "because the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action." *Medtronic*, ___ U.S., at ___, 64 U.S.L.W. at 4629.

Pre-emption under the Supremacy Clause is always a matter of Congress' manifest intent. *Cipollone*, 504 U.S., at 516. Congress may define the pre-emptive effect of a federal law either expressly or by implication, *id.*, but where Congress has expressed its intent to pre-empt state law, courts must apply "a narrow interpretation of such an express command." *Medtronic*, ___ U.S., at ___, 64 U.S.L.W. at 4629; *see also Cipollone*, 504 U.S., at 523.

In recent years, this Court has repeatedly instructed lower courts to limit their pre-emption analysis where Congress has clearly expressed its intent. In *Cipollone*, this Court stated:

> When Congress has considered the issue of pre-emption and has included in the enacted legislation a provision explicitly addressing that issue, and when that provision provides a "reliable indicium of congressional intent with respect to state authority," *Malone v. White Motor Corp.*, 435 U.S. [497] at 505 [98 S. Ct., 1185 at 1190, 55 L.Ed.2d 443 (1978)], "there is no need to infer congressional intent to pre-empt state laws from the substantive provisions" of the legislation. *California Federal Savings & Loan Assn. v. Guerra*, 479 U.S. 272, 282 [107 S. Ct. 683, 690, 93 L.Ed.2d 613] (1987) (opinion of MARSHALL, J.). Such reasoning is a variant of the familiar principle of *expressio unius est exclusio alterius:* Congress' enactment of a provision defining the pre-emptive reach of a statute implies that matters beyond that reach are not pre-empted.

Cipollone, at 517. In *Freightliner Corp. v. Myrick*, ___ U.S. at ___, 115 S. Ct., at 1488, this Court further explained that the existence of an explicit pre-emption provision "supports an inference that an express pre-emption clause forecloses implied pre-emption" even though "it does not establish a rule."

In *Medtronic*, this Court not only limited its pre-emption analysis to the express language of the pre-empting statute, it interpreted that language narrowly, relying on the "presumption against the pre-emption of state police power regulations." *Medtronic*, ___ U.S., at ___, 64 U.S.L.W. at 4629 (quoting *Cipollone*, 504 U.S., at 523). In that case, this Court hewed its pre-emption analysis strictly to the express

terms of the pre-emption clause found in 21 U.S.C. § 360k(a). In Section 360k(a), Congress pre-empted any state requirement relating to the safety or effectiveness of a medical device where the requirement is different from or in addition to a federal requirement applicable to medical devices. While the Court looked to both the context and the statutory history of Section 360k(a), *see Medtronic*, ___ U.S., at ___, 64 U.S.L.W. at 4629-30, its entire analysis rested on whether the common law duties imposed on medical device manufacturers were "requirements" or were "applicable to the device" within the meaning of § 360k(a). *Id.*, ___ U.S., at ___, 64 U.S.L.W. at 4629-34. In other words, the pre-emption analysis begins with the language of the statute. Where that language is unambiguous, "judicial inquiry is complete." *Connecticut Bank v. Germain*, 503 U.S. 249, 254 (1992).

B. Congress Expressly Pre-empted Only Preexisting State Regulation of Soft Dollar Order Flow Inducements; It Chose Not to Preempt State Regulation of Cash Kickbacks.

Congress expressly and precisely pre-empted state regulation of certain order flow inducement practices. The cash order flow kickbacks that Schwab receives on its customers' behalf do not fall within the reach of this express pre-emption clause and are therefore subject to concurrent state and federal regulation.

Specifically, in 1975 Congress enacted Section 28(e)(1) of the Exchange Act (15 U.S.C. § 78bb(e)(1)). In that amendment, Congress pre-empted only those state fiduciary laws which would absolutely prohibit money managers from dealing with broker-dealers who offer soft-dollar inducements for order flow (such as brokerage or research services), where other broker-dealers would have charged the investor a lower commission but offered no inducements to the money

manager.[8] The most striking feature of this pre-emption provision was that Congress chose to apply it only to pre-existing statutes and common law duties. The pre-emption clause does *not* apply to laws "enacted by . . . any State subsequent to June 4, 1975." 15 U.S.C. § 78bb(e)(1). Congress thus preserved the States' right to enact new laws which would prohibit these soft-dollar inducements.

This sharply-defined pre-emption clause demonstrates Congress' sensitivity to the States' historic right to regulate their licensed brokers under standard agency principles. More important, it provides the "reliable indicium" of Congress' intent that this Court pointed to in *Malone v. White Motor Corp.*, 435 U.S. 497, 505 (1978) and which this Court found in *Medtronic*. Congress has scrutinized the fiduciary ramifications of inducements for order flow and has expressly chosen *not* to pre-empt applicable state law except as it applies to soft dollar practices.

In contrast to this Court's decisions and the statutory language, the Minnesota Supreme Court chose to find a broad implied intent of Congress to pre-empt state agency law despite Congress' express pre-emption statement. The logical result of the Minnesota court's decision is that the States may not apply fiduciary and agency law to cash kickback practices, on which Congress has been silent, even though the States clearly may regulate and even prohibit soft-dollar inducements, which Congress apparently favors. Section 28(e)(1), 15 U.S.C. § 78bb(e)(1), does not support the Minnesota Supreme Court's conclusion. Had the Minnesota court followed this

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[8] In commenting on Section 28(e)(1), the SEC stated: "[ordinarily, a fiduciary that uses the assets of its managed accounts for its own benefit would be subject to claims of a breach of fiduciary duty under *state and federal law*." Payment for Order Flow, Exchange Act Release No. 30920 [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,012 (emphasis added). In other words, the SEC understands that fiduciaries who accept order flow inducements for their own benefit violate state agency law.

Court's mandate set out in *Cipollone* and *Freightliner*, it would have applied a "narrow interpretation of [Congress'] express command," *Medtronic*, ___ U.S., at ___, 64 U.S.L.W. at 4630, and would never have delved into an implied pre-emption analysis.

C. This Case Presents this Court with the Opportunity to Apply the *Medtronic* Pre-emption Analysis in the Context of the Securities Exchange Act.

This Court in *Cipollone* and *Freightliner* hypothesized the situation in which an express pre-emption clause leaves no room for defining Congressional intent through an implied pre-emption analysis. The hypothetical became concrete in the context of the Medical Devices Act in *Medtronic, Inc.* Now, this Court has the opportunity to apply and to verify in a securities case the principles expressed in all three of these decisions.

This Court has had few opportunities to analyze the pre-emptive effect of specific securities laws. *See* Francis J. Facciolo & Richard L. Stone, *Avoiding the Inevitable: The Continuing Viability of State Law Claims in the Face of Primary Jurisdiction and Preemption Challenges Under the Securities Exchange Act of 1934*, 1995 Colum. Bus. L. Rev. 525, 543-47 (1995).

> In fact, the Supreme Court has only dealt with the preemptive effect of the Exchange Act in two contexts: in the context of state takeover laws and that of self-regulatory organization rules. The primary means by which the Supreme Court has restrained the growth of federal law into the areas of state corporate law and state securities regulation has been the limited philosophy behind the federal

> securities laws that the Supreme Court has ascribed to Congress, combined with a literalist reading of the statutory language. The effect of these cases has been to defer to state judicial and legislative initiatives in most areas of corporate law.

Id. at 547-49 (footnotes omitted).[9] This case presents the rare opportunity to analyze the pre-emptive scope of the securities laws.

In *Freightliner*, this Court clarified a misperception that had arisen following the decision in *Cipollone*. Specifically, this Court explained that the existence of an express pre-emption clause does not necessarily foreclose all implied pre-emption analysis. *Freightliner*, ___ U.S., at ___, 115 S. Ct. at 1487-88. However, where Congress expresses its intent to pre-empt state law, and where the terms of the pre-emption clause provide a reliable indicium of Congress' intent, an implied pre-emption analysis is neither necessary nor appropriate. *Id.*; *Cipollone*, 504 U.S., at 517, 112 S. Ct. at 2618. Thus, where Congress has expressly pre-empted certain state laws concerning soft dollar order flow practices, standard rules of statutory construction require courts to limit their

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[9] This law review article provides a comprehensive analysis of payment for order flow practices. Francis J. Facciolo & Richard L. Stone, *Avoiding the Inevitable: The Continuing Viability of State Law Claims in the Face of Primary Jurisdiction and Preemption Challenges Under the Securities Exchange Act of 1934*, 1995 Colum. Bus. L. Rev. 525, 640-47 (1995). It also reviews this and other order flow cases currently pending in state and federal courts throughout the country. *Id.* at 654-69. The authors' analysis of this case is especially complete. *Id.* at 657-64.

Finally, Facciolo and Stone analyze this Court's recent decisions in *Freightliner*, *O'Melveny & Myers v. FDIC*, ___ U.S. ___, 114 S. Ct. 2048 (1994) and *Cipollone*, concluding that nothing in Rule 10b-10 or any other Federal law or regulation pre-empts state regulation of order flow kickback practices. Facciolo & Stone, at 670-74.

Supremacy Clause analysis to those express pre-emption provisions.

The Minnesota Supreme Court failed to follow this Court's mandate to abide by Congress' express intent to allow the States to regulate order flow inducements. In Section 28(e)(1) of the Exchange Act, Congress reaffirmed its historic commitment to dual state and federal securities regulation when it preserved state authority to regulate order flow inducements. It intended its pre-emption of certain soft-dollar regulations "to work the least possible interference with State law." S. Rep. No. 75, 94th Cong., 1st Sess. 139, *reprinted in* 1975 U.S. Code Cong. & Admin. News 179, 316. The Minnesota Supreme Court ignored both the intent and the painstakingly precise language of Section 28(e)(1). Petitioners call on this Court to correct the Minnesota Supreme Court's error in applying an implied pre-emption analysis where Congress has made clear its intent to preserve state law.

CONCLUSION

Petitioners respectfully ask this Court to issue a Writ of Certiorari, in order to resolve the important questions of federalism and pre-emption raised by the decision of the Minnesota Supreme court. In the alternative, and in light of this Court's recent decision in *Medtronic, Inc. v. Lohr*, petitioners ask this Court to summarily vacate the judgment of the Minnesota Supreme Court and remand for further proceedings consistent with the *Medtronic* decision.

Dated: July 17, 1996

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545 N.W.2d 918

64 USLW 2689, Fed. Sec. L. Rep. ¶ 99,220

(Cite as: 545 N.W.2d 918)

Kirk DAHL, et al., on behalf of themselves and all others similarly situated, Respondents,

v.

CHARLES SCHWAB & CO., INC., Petitioner, Appellants.

No. C1-94-1040.

Supreme Court of Minnesota.

April 19, 1996.

Investors filed three separate but similar class actions against securities broker contending that broker's acceptance of "order flow payments" from wholesale securities dealers violated fiduciary duties under common law of agency, Uniform Deceptive Trade Practices Act, and Prevention of Consumer Fraud Act. The District Court, Hennepin County, Robert Lynn, J., granted summary judgment for defendant, and plaintiffs appealed. The Court of Appeals, Amundson, J., 524 N.W.2d 742, reversed. The Supreme Court, Gardebring, J., held that federal securities law regarding "order flow payments" preempted any consent requirements under state common law of agency or state consumer protection statutes.

Reversed.

[1] STATES 18.13

Federal preemption analysis begins with assumption that historic police powers of the states are not to be eclipsed unless to do so was clear and manifest purpose of Congress. U.S.C.A. Const. Art. 1, § 6, cl. 1.

[2] SECURITIES REGULATION 82

While self-regulatory organizations (SRO) such as National Association of Securities Dealers (NASD) may regulate, only Securities and Exchange Commission (SEC) does so with authority of and on behalf of Congress, for purposes of preemption of state law. U.S.C.A. Const. Art. 1, § 6, cl. 1; Securities Exchange Act of 1934, § 19(c)(4)(C), 15 U.S.C.A. § 78s(c)(4)(C).

[2] STATES 18.77

While self-regulatory organizations (SRO) such as National Association of Securities Dealers (NASD) may regulate, only Securities and Exchange Commission (SEC) does so with authority of and on behalf of Congress, for purposes of preemption of state law. U.S.C.A. Const. Art. 1, § 6, cl. 1; Securities Exchange Act of 1934, § 19(c)(4)(C), 15 U.S.C.A. § 78s(c)(4)(C).

[3] STATES 18.5

State law is implicitly preempted if Congress has entirely displaced possibility of state regulation or if state regulation conflicts with federal law. U.S.C.A. Const. Art. 1, § 6, cl. 1.

[3] STATES 18.7

State law is implicitly preempted if Congress has entirely displaced possibility of state regulation or if state regulation conflicts with federal law. U.S.C.A. Const. Art. 1, § 6, cl. 1.

[4] STATES 18.3

Four main considerations relevant to inquiry into whether Congress has impliedly displaced possible state regulation are whether: scheme of federal regulation may be so pervasive as to leave no room for supplemental state action; federal interest may be so dominant that state regulation will be presumptively precluded; objective of federal regulation may reveal preemptive purpose; or state policy may produce result inconsistent with federal objective. U.S.C.A. Const. Art. 1, § 6, cl. 1.

[5] STATES 18.5

State law will conflict with federal law, for preemption purposes, when compliance with both federal and state regulations is physical impossibility or where state law stands as obstacle to accomplishment and execution of full purposes and objectives of Congress. U.S.C.A. Const. Art. 1, § 6, cl. 1.

[6] SECURITIES REGULATION 35.10

Federal oversight of securities industry is designed to protect investing public, remove impediments to smooth operation of national market system, and impose reporting requirements that would ensure fair and honest market. Securities Exchange Act of 1934, § 2, 15 U.S.C.A. § 78b.

[7] SECURITIES REGULATION 241

Congress did not intend to exclude states from concurrent regulation of the securities industry, but instead, intended to subject exchanges to state regulation that is not inconsistent with federal law. U.S.C.A. Const. Art. 1, § 6, cl. 1.

[7] STATES 18.77

Congress did not intend to exclude states from concurrent regulation of the securities industry, but instead, intended to subject exchanges to state regulation that is not inconsistent with federal law. U.S.C.A. Const. Art. 1, § 6, cl. 1.

[8] PRINCIPAL AND AGENT 48

Agent must act solely for benefit of his or her principal in all matters connected with agency; profits made in course of agency belong to principal whether they are fruits of performance or violation of agent's duty, and agent may not profit from relationship nor engage in self-dealing without principal's consent after full disclosure of facts which might affect principal's decision.

[8] PRINCIPAL AND AGENT 69(2)

Agent must act solely for benefit of his or her principal in all matters connected with agency; profits made in course of agency belong to principal whether they are fruits of performance or violation of agent's duty, and agent may not profit from relationship nor engage in self-dealing without principal's consent after full disclosure of facts which might affect principal's decision.

[9] SECURITIES REGULATION 241

Rules of Securities and Exchange Commission (SEC) on disclosure of "order flow payments," whereby securities broker is paid by wholesale securities dealer for routing of buy and sell orders, impliedly preempted consent requirements which could be based on fiduciary duties under state's common law of agency or on state consumer protection statutes. M.S.A. §§ 325D.43-325D.48, 325F.68-325F.70; 17 C.F.R. § 240.10b-10(a)(7).

[9] STATES 18.77

Rules of Securities and Exchange Commission (SEC) on disclosure of "order flow payments," whereby securities broker is paid by wholesale securities dealer for routing of buy and sell orders, impliedly preempted consent requirements which could be based on fiduciary duties under state's common law of agency or on state consumer protection statutes. M.S.A. §§ 325D.43-325D.48, 325F.68-325F.70; 17 C.F.R. § 240.10b-10(a)(7).

Syllabus by the Court

The rules of the Securities and Exchange Commission on disclosure of order flow payments impliedly preempt consent requirements which might be based upon the state's common law of agency or state consumer protection statutes.

Review of Court of Appeals.

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Robert L. Schell, Jr., Jeffrey D. Hedlund, R. Christopher Sur, Minneapolis, Stuart J. Kaswell, Senior Vice President & Gen. Counsel, Securities Industry Ass'n, Inc., Washington, DC, Amicus Curiae.

Heard, considered and decided by the court en banc.

OPINION

GARDEBRING, Justice.

This case calls upon us to decide if federal regulation of the national securities market preempts the application of Minnesota common and statutory law to certain securities sales in Minnesota.

Respondents are Minnesota citizens who utilized appellant Charles Schwab & Co. as their broker for the buying and selling of securities. Schwab charges a commission to its customers for its services, but also, as is common within the securities industry, Schwab receives payments from wholesale securities dealers for the routing of buy and sell orders like those of respondents. These payments, called payments for order flow, involve the remittance of a few pennies per share to a broker-dealer, such as Schwab, as incentive to the broker-dealer to route its customers' orders through the wholesaler.

Respondents allege that these payments--which they label kickbacks--constitute a breach of Schwab's fiduciary responsibilities under the state's common law of agency and a violation of Minnesota Uniform Deceptive Trade Practices Act, Minn.Stat. § 325D.43-48, and the Minnesota Prevention

of Consumer Fraud Act, Minn.Stat. § 325F.68-70. Respondents therefore filed three separate but similar class actions contending that Schwab's acceptance of order flow payments violated these Minnesota common law and statutory requirements. Respondents sought relief of several kinds: 1) an accounting of all of Schwab's profits received in transactions conducted on respondents' behalf; 2) the forfeiture of all payments made to Schwab by any wholesale stock dealers for routing of either respondents' or class members' securities transactions; 3) a declaration that Schwab fraudulently concealed its wrongdoing; and 4) an injunction to prevent Schwab from receiving payment for order flow without the customers' consent.

Schwab moved to dismiss the complaints, asserting that granting the relief sought by respondents would violate the Supremacy Clause, and thus, that application of Minnesota law was in this instance preempted by SEC rulemaking. The trial court agreed and entered summary judgment in favor of Schwab. The court of appeals, however, reviewed the SEC rules governing order flow and concluded that the additional disclosure allegedly required by the application of Minnesota law was neither inconsistent with the then-applicable federal rules, nor an obstacle to the accomplishment of the objectives of the federal regulations. The court of appeals declined to consider the application of recent SEC rules, which had not then come into force. We reverse, concluding that, indeed, the SEC rules impliedly preempt the application of Minnesota's common law of agency and statutory consumer protection provisions.[1]

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[1] In addition to arguments and briefing from both sides to this court, the Securities Industry Association submitted a brief as amicus curiae. The SIA, a trade association of securities firms, presents arguments substantially similar to those proffered by Schwab.

The 1934 Securities Act created the Securities and Exchange Commission, charging it with the close regulation and oversight of the national securities market. 15 U.S.C. § 78b (1992). This regulatory activity is conducted with the assistance of the industry itself. For example, participants in the securities market are also regulated by private associations, called self- regulatory organizations or SROs, which engage in rulemaking and oversight similar to and closely tied to that of the SEC and serve as a source of valuable information for SEC regulatory efforts. Though private, the activities of SROs are related to regulation by the SEC to the extent that their internal rules are subject to SEC review and approval. 15 U.S.C. § 78s(b). The SEC may even adjust these internal rules if it decides that to do so will further the purposes of the Act. 15 U.S.C. § 78s(c).

Order flow payments, the mechanism at the heart of this lawsuit, are commonly used in the securities industry. Order flow involves the activities of wholesale securities dealers, broker-dealers, and purchasers of stock. The wholesale dealers, sometimes called market makers, profit on the difference between the price they offer for purchase and the price they offer for sale of a particular stock. A wholesaler, therefore, may buy 10 shares at $10 per share and sell 10 shares at $10 1/4 per share to make a gross profit $.25 per share, or $2.50. Because their margin is so narrow, wholesale stock dealers must buy and sell in great volume--the more trades, the more profit. Thus, in an attempt to maintain a continuous flow of orders, some wholesaler dealers share a portion of their gross profit with the broker-dealers. This payment, usually some percentage of the gross profit of a large block order of stock transactions, encourages the broker-dealers to keep their orders flowing to a particular wholesale dealer.

The practice of payments for order flow began in the 1960s and is now widespread in the securities industry. The

SEC estimates that between 15% and 20% of order flow is in listed stocks pursuant to cash payment arrangements. There is, however, no available estimate for the dollar amount paid in *order flow inducements*. Paying for order flow and the question of whether or not it can be quantified on a per share basis is controversial within the securities industry. Some industry participants believe that the fact that a market maker would be unwilling to pay for the placing of a single order does not negate the connection between payment for order flow and the order. These industry members point out that order flow payments are usually specified in an amount per share.

In contrast, other industry players contend that the benefits derived from aggregating orders cannot be parsed out to such a degree as to apply to individual orders because no brokerage firm would negotiate such a small fee reduction (or other benefit) for a single or a small number of orders. In addition, identifying order flow payments on an order-by-order basis is made more difficult by the fact that some order flow payments are noncash equivalents, such as market research services. Observing this controversy, the SEC decided in 1993 to study its overall impact on the industry. *See, e.g.*, SEC Release No. 34-33026 at 29 (October 6, 1993).

In 1977, the SEC adopted rules governing the disclosure necessary between customers and securities dealers. These rules, aggregated in and now commonly referred to as Rule 10b-10, responded to changing market conditions and practices by requiring brokers and dealers to disclose in what capacity a broker or dealer acted when effecting a transaction (e.g., if and for whom the broker or dealer acted as an agent), the time and date of the transaction, the amount of remuneration received, and the source and amount of any other remuneration received. *See* 17 C.F.R. § 240.10b-10 (1994). With respect to the final requirement, however, the SEC noted that, in the case of an ordinary sale (e.g., not a

tender offer), the broker or dealer could simply disclose that other remuneration may be received and that the source and amount would be made available at the customer's request. *Id.* When it adopted the rule, the *SEC* noted that it designed the rule to give "the investor the maximum information consonant with cost effectiveness and with his need to make investment decisions." SEC Rel. No. 12806 at 19.

At the time respondents engaged in their securities trading with Schwab, Rule 10b-10 prescribed what information Schwab was obligated to disclose to its customers. These disclosure requirements did not mention order flow specifically and required that, with respect to so-called "other remuneration," brokers need only disclose that they may have received other remuneration and that further information would be available on request. *See* 17 C.F.R. § 240.10b-10(a)(7) (1994). In 1993, the SEC, in accordance with its own and some SRO studies relating to order flow payments, proposed amendments to Rule 10b-10 and offered a new rule for comment. The amendments to Rule 10b-10 defined "order flow payments" as any form or arrangement compensating brokers or dealers in return for the routing of orders. They further required disclosure on each transaction confirmation slip that payment for order flow either was or was not received and that the source and nature of the payment would be available at the customer's request. The new rule, 11Ac1-3, would require annual disclosure to customers of a broker's or dealer's policies regarding receipt of payment for order flow, the market makers to which customer orders are routed, and the aggregate amount of payment received for order flow in the previous year. *See* SEC Rel. No. 34-33026 at 5 (October 6, 1993). These rules were adopted on October 27, 1994, but the effective date of the rules was postponed from April 3, 1995 to October 2, 1995. While the amendments to 10b- 10 and new Rule 11Ac1-3 govern order flow payments more directly, they were not in

effect during the time of respondent's trading activity and are thus not relevant to our preemption inquiry.

Industry SROs participated in the SEC's study of order flow payments, offered their comments on the proposed rulemaking, and adopted rules of their own. The National Association of Securities Dealers (NASD) is one of the largest SROs and operator of the NASDAQ securities market. In 1984, NASD established a special committee to consider the practice of paying for order flow. This committee eventually concluded that disclosure of such payments should be mandated. *See* SEC Rel. No. 34-33026 (October 6, 1993). The following year, on April 30, 1985, NASD issued a Notice to Members alerting its members of the requirements of Rule 10b-10 and reminding them of the need to obtain best execution of trades for their customers. *See* NASD, Notice to Members No. 85- 32 (April 30, 1985). It also explained that NASD was studying the practice for possible rulemaking.

The above discussion indicates that two rules specifically governing order flow payments were effective during the time that respondents traded with Schwab: Rule 10b-10 and the NASD Notice to Members. We must therefore review Rule 10b-10 and the NASD Notice to Members to determine whether the SEC, either expressly or impliedly, has preempted state regulation of order flow payments.

[1] Preemption analysis begins with the assumption that the "historic police powers of the [s]tates" are not to be eclipsed unless to do so was "the clear and manifest purpose of Congress." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S.Ct. 1146, 1152, 91 L.Ed. 1447 (1947). The clearest indication of such Congressional intent is express language; if Congress expressly preempts state action, the matter is settled. *Jones v. Rath Packing Co.*, 430 U.S. 519, 525, 97 S.Ct. 1305, 1309, 51 L.Ed.2d 604 (1977). Without the guidance of express language, courts must decide whether Congress implied the preemption of state regulation.

Schwab and respondents each argue that express preemption analysis favors their position. On the one hand, respondents argue that Congress has expressly defined the preemptive reach of its regulation of market makers, and therefore state-mandated disclosure requirements are not preempted. On the other hand, Schwab counters that SEC Rule 10b-10, the NASD Notice to Members rule, and the SEC study leading up to and including the proposed Rule 11Ac1-3 amount to federal regulation of disclosure requirements concerning order flow payments, thereby expressly preempting any state regulation on the same subject. Neither contention is persuasive.

Respondents' argument for express preemption centers around the so-called "savings clause" contained in the Exchange Act. 15 U.S.C. 78bb (1992). This clause operates to include state regulation in the universe of regulation covering the securities industry: (a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; * * * Nothing in this chapter shall affect the jurisdiction of the securities commissions (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder. 15 U.S.C. 78bb(a) (as amended October 13, 1982).

Respondents assert that this clause explicitly defines the areas of state law that are preempted and, thus, other areas of securities regulation are open to the states. *See Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 517, 112 S.Ct. 2608, 2618, 120 L.Ed.2d 407 (1992). In *Cipollone*, the Court, relying on the "familiar principle of *expression unius est exclusio alterius*," held that a congressional definition of a statute's preemptive scope implies that matters beyond that scope are not preempted. *Id.* Respondents rely on *Cipollone* as support for their assertion that express preemption

eliminates the possibility of any determination of implied preemption. They read *Cipollone* to state that, if Congress considered the preemptive possibilities of its legislation and chose to include a provision explicitly on preemption, then Congress has given " 'reliable indicium of [its] intent with respect to state authority' " and there is no need to examine whether implied preemption might apply. *Id.* (quoting *Malone v. White Motor Corp.*, 435 U.S. 497, 505, 98 S.Ct. 1185, 1191, 55 L.Ed.2d 443 (1978)).

Respondents' argument, however, does not survive a recent U.S. Supreme Court case on preemption. In *Freightliner Corp. v. Myrick*, --- U.S. ----, ----, 115 S.Ct. 1483, 1488, 131 L.Ed.2d 385 (1995), the Court specifically addressed this same contention and found it spurious. The *Freightliner* court held that *Cipollone* does not establish the rule that respondents attempt to construct with a few well-chosen quotes. Instead, "[t]he fact that an express definition of the pre-emptive reach of a statute 'implies'--i.e. supports a reasonable inference--that Congress did not intend to pre-empt other matters does not mean that the express clause entirely forecloses any possibility of implied pre-emption." *Id.* Hence, the savings clause does not prevent implied preemption of areas of securities law not specified in the clause.

Schwab's argument for express preemption is grounded in the requirements of Rule 10b-10. It argues, simply, that Rule 10b-10's disclosure requirements cover order flow payments, thus preempting state regulation. *See* 17 C.F.R. § 240.10b-10 (1994). In support of this position, it points to a 1985 NASD notice alerting members that Rule 10b-10 covers order flow payments, asserting that the fact that the SEC did not object to the notice is evidence that the SEC approved of its contents, thus further manifesting an express preemption. As evidence that the rule was intended to cover order flow payments, Schwab cites to a discussion in the same document stating that portions of Rule 10b-10 wouid "relate to situations where

payments were made to the dealer to induce transactions in securities." SEC Rel. No. 12806 at 22 (September 16, 1976).

However, we conclude that such rules do not expressly preempt state activity. At the time of the enactment of Rule 10b-10, the SEC was aware of the practice of order flow payments, despite the fact that it was not widespread. *See* SEC Rel. No. 34-33026 at 11. However, Rule 10b-10 does not plainly state that "other remuneration" includes order flow payments. The SEC, therefore, had no rule in place expressly mentioning order flow payments. It might be possible to read Rule 10b-10 as relating to situations involving paying for order flow, but the language of the rule does not rise to the level of a "clear and manifest purpose" mandated by the Supreme Court. *Rice*, 331 U.S. at 230, 67 S.Ct. at 1152. Given that there is also no contemporaneous commentary by the SEC indicating that the rule applied to order flow payments, if there is any preemptive force in Rule 10b-10, it is implied, not express.

Schwab also relies on a 1985 NASD notice to its members that Rule 10b-10 applies to order flow payments. The notice alerted members that they should consider payments received for order flow to be "other remuneration" that they should disclose in accordance with Rule 10b-10. Schwab asserts that because the SEC can control the internal rules of self-regulatory organizations like the NASD, its rules should be considered part of the federal regulatory scheme.

[2] Schwab's reliance on the NASD notice to its members is also unavailing. If the SEC had issued this notice instead of the NASD, then the express preemption question would be a closer one. But Congress did not delegate supervision of the securities industry to the industry itself. SROs are not governmental agencies, they are private associations. Certainly, the Commission may "abrogate, add to, and delete from * * * the rules of a self- regulatory organization * * *." 15 U.S.C. § 78s(c). Yet, in 15 U.S.C. § 78s(c)(4)(C),

Congress stated that "[a]ny amendment to the rules of a self-regulatory organization made by the Commission pursuant to this subsection shall be considered for all purposes of this chapter to be part of the rules of such self-regulatory organization and shall not be considered to be a rule of the Commission." Therefore, while SROs may regulate, only the SEC does so with the authority of and on behalf of the Congress. The fact that some in the securities industry may have considered Rule 10b-10 applicable to order flow payments has no effect on whether the SEC intended it to be such. Neither Rule 10b-10, nor the NASD Notice to Members, therefore, expressly preempted the application of state law.

[3][4][5] It is possible, however, that the state regulation at issue here is impliedly preempted by the operation of federal law. The United States Supreme Court has identified a two-pronged analysis for determining whether Congress made such an implication. State law is preempted if Congress has entirely displaced the possibility of state regulation or if state regulation conflicts with federal law. *Pacific Gas & Electric v. State Energy Resources Comm'n.*, 461 U.S. 190, 204, 103 S.Ct. 1713, 1722, 75 L.Ed.2d 752 (1983). The Court has indicated that four main considerations are relevant to an inquiry into whether Congress has impliedly displaced possible state regulation: 1) the scheme of federal regulation may be so pervasive as to leave no room for supplemental state action; 2) the federal interest may be so dominant that state regulation will be presumptively precluded; 3) the objective of the federal regulation may reveal a preemptive purpose; or 4) the state policy may produce a result inconsistent with that federal objective. *Id.* State law will conflict with federal law when "compliance with both federal and state regulations is a physical impossibility" or where state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Id.* (quoting *Florida*

Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43, 83 S.Ct. 1210, 1217-18, 10 L.Ed.2d 248 (1963) and *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S.Ct. 399, 404, 85 L.Ed. 581 (1941)).

[6][7] Federal oversight of the securities industry is designed to protect the investing public, remove impediments to the smooth operation of a national market system, and impose reporting requirements that would ensure a fair and honest market. *See* 15 U.S.C. § 78b; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668, *reh'g denied*, 425 U.S. 986, 96 S.Ct. 2194, 48 L.Ed.2d 811 (1976). Congress delegated to the Securities and Exchange Commission primary responsibility for regulating the securities industry and protecting the public, and gave the SEC broad rule-making authority to effect this goal. *See* 15 U.S.C. §§ 78h, 78i, and 78k (1992). It is clear, however, that Congress did not intend to exclude states from concurrent regulation of the securities industry: "Congress intended to subject the exchanges to state regulation that is not inconsistent with the federal Act." *Merrill Lynch, Pierce, Fenner & Smith v. Ware*, 414 U.S. 117, 137, 94 S.Ct. 383, 394, 38 L.Ed.2d 348 (1973). Thus, state and federal regulation can coexist, but in the case of a conflict, federal law preempts concomitant state regulation. To ascertain if a state law is impliedly preempted, a determination must be made that either compliance with both state and federal law is a physical impossibility, or that the state law presents an obstacle to the accomplishment of the purpose of the federal law. *See Pacific Gas & Electric*, 461 U.S. at 204, 103 S.Ct. at 1722.

There is no denying the fact that the securities industry has a national or, if more broadly considered, an international scope. The order flow payment device is used by stock wholesalers throughout the industry and, therefore, around the nation. Moreover, as respondents reminded us at oral argument, millions of dollars are involved in order flow

payments. A decision by this court affecting these payments will no doubt reach far beyond the borders of Minnesota.

As noted earlier, respondents sought various forms of relief, several of which go beyond disclosure of the order flow payment associated with a specific transaction. Schwab admits that complying with both state and federal disclosure requirements is theoretically possible, but, respondents also sought relief under state agency law which, they argue, requires consent as well as disclosure. Federal regulations plainly do not require such consent; therefore, given the broad nature of the relief sought, there is still a question of whether a conflict may exist between state requirements and federal regulation.

Schwab asserts that the consent that respondents say state agency law requires is impossible to achieve. Schwab contends that it is impossible to determine the precise amount of money from each order that represents an order flow payment because such payments are made in the aggregate, a few pennies per share on average in a total order of hundreds, thousands or tens of thousands of shares, or are made as non-cash equivalents which may be impossible to associate with individual sales. Therefore, Schwab says, any ruling which implies that the order flow payments might have to be remitted to the customer on a case-by-case basis would be impossible to fulfill and would require the termination of the practice of order flow payments. Respondents assert, in contrast, that customers could simply consent when they sign their brokerage agreements, for example.

[8] Schwab's argument is credible and compelling. Minnesota law requires an agent to act solely for the benefit of his or her principal in all matters connected with the agency. *Doyen v. Bauer*, 211 Minn. 140, 300 N.W. 451 (1941). "[P]rofits made in the course of the agency belong to the principal whether they are the fruits of performance or violation of the agent's duty." *Id.* at 454. An agent may not

profit from the relationship nor engage in self-dealing without the principal's consent after full disclosure of facts which might affect the principal's decision. *See Carlson v. Carlson*, 363 N.W.2d 803, 805 (Minn.App.1985); *Handy v. Garmaker*, 324 N.W.2d 168, 173 (Minn.1982). For Schwab to fully comply with these state agency law requirements, it would need to be able to ascertain the exact amounts of these profits in order to seek its clients' consent, or to remit them to its customers if consent were withheld. Since it cannot parse out order flow payments to such a degree, compliance with the potential consent requirements of Minnesota law might put an end to the practice of order flow payments, which is allowed under federal law. Thus, the remedy respondents seek could frustrate the objectives of the SEC and Congress. *See Merrill Lynch*, 414 U.S. at 137, 94 S.Ct. at 394. Congress intended the SEC to regulate the securities markets and industry to encourage competition.

[9] We believe that order flow payments are a useful competitive tool and that a decision requiring them to be returned to the customer would have a seriously negative impact on the efficacy of this tool. In turn, given the complicated and intricate nature of the securities industry, anything affecting a practice as widely utilized as this one will have a significant impact on the securities markets nationwide. Whether this impact will be positive or negative is not for this court to judge. It is sufficient for us to identify the national import and possible effect of our decision and recognize that decisions with such a reach are for the SEC and Congress.[2]

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[2] Schwab also raises an argument that this court should defer to the primary jurisdiction of the SEC in this matter. Because our ruling on the preemption question is dispositive of this case, we decline to address the primary jurisdiction issue.

The decision of the court of appeals is reversed and the trial court's grant of summary judgment reinstated.

Reversed.

524 N.W.2d 742

Fed. Sec. L. Rep. ¶ 98,735

(Cite as: 524 N.W.2d 742)

Kirk DAHL, et al., on behalf of themselves and all others similarly situated, Appellants,

v.

CHARLES SCHWAB & CO., INC., Respondent.

No. C1-94-1040.

Court of Appeals of Minnesota.

Dec. 13, 1994.

Review Granted Feb. 14, 1995.

Plaintiffs brought suit against brokerage firm, challenging firm's scheme for handling order flow payments from wholesale dealers without adequate disclosure. The District Court, Hennepin County, Robert Lynn, J., granted summary judgment for firm, and plaintiffs appealed. The Court of Appeals, Amundson, J., held that: (1) action was not preempted, and (2) action was not within primary jurisdiction of Securities and Exchange Commission (SEC).

Reversed and remanded.

[1] APPEAL AND ERROR 863

On appeal from summary judgment, role of reviewing court is to review record for purposes of determining whether there

are any genuine issues of material fact and whether trial court erred in its application of the law.

[2] APPEAL AND ERROR 842(1)

Court of Appeals need not defer to district court's decision on purely legal issue.

[3] STATES 18.3

State regulation will survive in Supremacy Clause challenge where it is stricter than federal regulation regarding same conduct, so long as compliance with both is not impossible. U.S.C.A. Const. Art. 6, cl. 2.

[4] SECURITIES REGULATION 244

Actions challenging brokerage firm's scheme for handling order flow payments from wholesale dealers without adequate disclosure were not preempted by federal law; compliance with both federal and state regulation was not an impossibility, and there was no conflict between state common or statutory law and federal law concerning regulation of order flow payments. U.S.C.A. Const. Art. 6, cl. 2; M.S.A. § 80A.06, subd. 5; 17 C.F.R. § 240.10b- 10(a)(7)(iii).

[4] SECURITIES REGULATION 303.1

Actions challenging brokerage firm's scheme for handling order flow payments from wholesale dealers without adequate disclosure were not preempted by federal law; compliance with both federal and state regulation was not an impossibility, and there was no conflict between state common or statutory law and federal law concerning regulation of order flow payments. U.S.C.A. Const. Art. 6, cl. 2; M.S.A. § 80A.06, subd. 5; 17 C.F.R. § 240.10b- 10(a)(7)(iii).

[4] STATES 18.77

Actions challenging brokerage firm's scheme for handling order flow payments from wholesale dealers without adequate disclosure were not preempted by federal law; compliance with both federal and state regulation was not an impossibility, and there was no conflict between state common or statutory law and federal law concerning regulation of order flow payments. U.S.C.A. Const. Art. 6, cl. 2; M.S.A. § 80A.06, subd. 5; 17 C.F.R. § 240.10b- 10(a)(7)(iii).

[5] ADMINISTRATIVE LAW AND PROCEDURE 228.1

Doctrine of primary jurisdiction is inapplicable if issues raised are inherently judicial unless legislature has explicitly granted exclusive jurisdiction to administrative body.

[6] ADMINISTRATIVE LAW AND PROCEDURE 228.1

Action challenging brokerage firm's scheme for handling order flow payments from wholesale dealers was not within primary jurisdiction of Securities and Exchange Commission (SEC); issues involved questions of law and did not require special fact-finding abilities of SEC.

[6] SECURITIES REGULATION 83

Action challenging brokerage firm's scheme for handling order flow payments from wholesale dealers was not within primary jurisdiction of Securities and Exchange Commission (SEC); issues involved questions of law and did not require special fact-finding abilities of SEC.

Syllabus by the Court

1. There is no conflict between Minnesota law and federal law concerning the regulation of order flow payments on sales of securities.

2. The retention of order flow payments by a securities brokerage firm does not involve any fact issues, thus the special expertise of the Securities and Exchange Commission is not needed. A district court is competent to apply Minnesota law to the facts and determine whether Minnesota law has been violated.

Karl L. Cambronne, Jeffrey D. Bores, Chestnut & Brooks, P.A., Minneapolis, Mark Reinhardt, Gavin S. Wilkinson, Reinhardt & Anderson, St. Paul, Charles H. Johnson, Garrett D. Blanchfield, Jr., Charles H. Johnson & Associates, New Brighton, for appellants.

Steve Gaskins, Jeannine L. Lee, Cosgrove, Flynn & Gaskins, Minneapolis, Norman J. Barry, Jr., Barrie L. Brejcha, Baker & McKenzie, Chicago, IL, for respondent.

Considered and decided by HARTEN, P.J., and DAVIES and AMUNDSON, JJ.

OPINION

AMUNDSON, Judge.

Appellants challenge the district court's grant of summary judgment, arguing (1) that their claims are not preempted by federal securities law, and (2) that the Securities and Exchange Commission does not have primary jurisdiction. We reverse and remand.

FACTS

Respondent Charles Schwab & Co., Inc. (Schwab) is a discount securities brokerage firm. If a stock is traded on a national or regional stock exchange, a broker such as Schwab has several options on how to execute a client's securities transaction. One option is for Schwab to place an order through a wholesale dealer who makes a market in the traded security. Under this practice, Schwab executes a buy order at the dealer's current ask price per share or executes a sell order at the dealer's bid price. The spread between the ask price and the bid price is the wholesale dealer's per share profit.

Dealers are often willing to return some of their spread, usually a few cents per share, in exchange for a brokerage firm's business. These dealer payments to brokerage firms such as Schwab are known in the securities industry as "order flow payments." Schwab does not remit the order flow payment to its clients.

Order flow payments are common in the industry and Schwab claims they are an integral part of the competitive structure of the national securities markets. Schwab argues that order flow payments allow a broker to charge lower commissions to its clients, thereby benefitting investors. Order flow payments have become a significant source of income for discount brokers, such as Schwab, whose declared commission may be only a few cents per share.

Schwab mails a confirmation slip after the client places an order. There is a limited disclosure on the reverse side of the confirmation slip to the effect that Schwab receives or may receive remuneration, other than a commission for the order. The disclosure does not set out the amount of remuneration.[1]

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[1] Specifically, the back side of the confirmation slip provides: If this is an OTC transaction, Charles Schwab & Co., Inc. may receive

Appellants Kirk Dahl, Robert Olson and Charles Dahl, on behalf of themselves and all others similarly situated, each commenced separate but identical actions challenging Schwab's scheme for handling order flow payments, based largely on Schwab's alleged breaches of Minnesota statutory and common law. In their complaints, appellants alleged that Schwab breached its fiduciary duty of full disclosure; breached its fiduciary duty to avoid self-dealing; had a duty under agency principles and the doctrine of money had and received to remit profits it received on account of the agency relationship; violated the Minnesota Uniform Deceptive Trade Practices Act, Minn.Stat. §§ 325D.43-48 (1992); and violated the Minnesota Consumer Protection Act, Minn.Stat. §§ 325F.68-70 (1992). Appellants sought damages, an accounting of Schwab's profits, injunctive relief, and attorney fees, costs, and disbursements.

The district court granted Schwab summary judgment, concluding that appellants' claims are preempted by federal securities law and that the Securities and Exchange Commission has primary jurisdiction over the issues. This appeal followed.

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remuneration from the broker through whom the transaction was executed. The amount of such remuneration may vary and will be disclosed to you upon request. Or, the slip provides: For OTC or listed securities transactions, Charles Schwab & Co., Inc. does receive remuneration from the broker/dealer through whom the transaction was executed. The amount of such remuneration may vary and will be disclosed to you upon request.

ISSUES

1. Did the district court err in determining that appellants' Minnesota common law and statutory claims are preempted by federal securities law?

2. Did the district court err in determining that appellants' claims should be deferred to the Securities and Exchange Commission under the doctrine of primary jurisdiction?

ANALYSIS

[1] On appeal from summary judgment, the role of the reviewing court is to review the record for the purpose of answering two questions: (1) whether there are any genuine issues of material fact and (2) whether the trial court erred in its application of the law. *Offerdahl v. University of Minn. Hosps. & Clinics*, 426 N.W.2d 425, 427 (Minn.1988). Summary judgment is proper when no genuine issues of material fact exist and one party is entitled to judgment as a matter of law. Minn.R.Civ.P. 56.03.

[2] This court need not defer to the district court's decision on a purely legal issue. *See Frost-Benco Elec. Ass'n v. Minnesota Pub. Utils. Comm'n*, 358 N.W.2d 639, 642 (Minn.1984).

I. Federal Preemption

The potential harms and benefits from the order flow payment scheme has caused much debate and controversy within the securities industry. Schwab claims that order flow payments have been studied by Congress, the SEC, and other regulatory organizations and allowed to flourish. Thus, Schwab asserts that appellants' attempt to have the practice declared illegal in Minnesota constitutes a clear threat to the

uniform operation of the national securities markets and a usurpation of the SEC's plenary regulatory power over the securities markets.

Congress has passed no statute dealing directly with order flow payments. At the time this case was argued, the SEC had not promulgated any final regulations regarding the receipt of order flow payments. The only federal regulation currently in effect concerning non-commission compensation is found in SEC Rule 10b-10(a)(7)(iii) codified at 17 C.F.R. § 240.10b-10(a)(7)(iii) (1994). It requires only that a broker send the client written notification disclosing whether any other remuneration has been or will be received and that the source and amount of such other remuneration will be furnished upon written request of such customer.[2]

Appellants argue that Minn.Stat. § 80A.06, subd. 5 (1992) applies to order flow payments and requires disclosure of the exact amount of remuneration. Section 80A.06, subdivision 5 provides that where a broker accepts remuneration in connection with the sale or purchase of the security, the broker must, prior to or contemporaneously with the confirmation of the transaction, provide written disclosure to the client or customer * * * of the acceptance or intended acceptance of the remuneration or other thing of value and the amount of it.

Neither the state law nor the SEC Rule deal specifically with order flow payments; rather, both provisions are catch-all provisions regarding disclosure of non-commission revenue. No federal or state law or regulation specifically

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[2] This provision applies to purchases in which the broker was not participating in a distribution, and sales in which the broker was not participating in a tender offer. 17 C.F.R. § 240.10b-10(a)(7)(iii).

provides whether a broker such as Schwab should receive or disclose order flow payments.[3]

The parties dispute whether current federal law preempts appellants' claims under Minnesota law.

The United State Supreme Court has stated: Pre-emption of state law by federal statute or regulation is not favored "in the absence of persuasive reasons--either that the nature of the regulated subject matter permits no other conclusion, or that Congress has unmistakenly so ordained." *Chicago & N.W. Transp. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311, 317, 101 S.Ct. 1124, 1130, 67 L.Ed.2d 258 (1981) (quoting *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142, 83 S.Ct. 1210, 1217, 10 L.Ed.2d 248 (1963)).[4]

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[3] On September 27, 1994, the Securities and Exchange Commission voted to amend Rule 10b-10 and adopt Rule 11Ac1-3 under the Securities Exchange Act of 1934 generally requiring enhanced disclosure of order flow payments. The new rule and amendments are designed to provide relevant information to customers regarding factors influencing the routing of their orders. The new rule and amendments will also serve to enhance investor protection and further competition for retail orders by enabling customers to evaluate more effectively the markets to which their orders are routed. The SEC released its final rule on October 27, 1994 to be effective April 3, 1995. *See* SEC Release No. 34-34902 (to be codified at 17 C.F.R. § 240). Because these changes have not yet taken effect, they have no effect on whether Schwab violated Minnesota law by failing to more fully disclose its handling of order flow payments. We do not reach the issue of whether Minnesota law will be preempted when Rule 11Ac1-3 and the amendment to Rule 10b-10 take effect.

[4] The parties agree that federal law does not completely preempt state law in the securities field. Section 28 of the Securities Exchange Act of 1934, as set forth in 15 U.S.C. § 78bb(a) (Supp.1994), provides: The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity. *See also Leroy v. Great W. United Corp.*, 443 U.S. 173, 182, 99 S.Ct. 2710, 2716, 61 L.Ed.2d 464 (1979) (noting that section 28 was "intended to protect rather than to limit, state authority"; *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117, 137, 94 S.Ct. 383, 394, 38

If Congress has not explicitly or implicitly displaced all state action in a specified field, the preemption doctrine still arises if compliance with both the federal and state law is an impossibility or when the state law is an obstacle to the accomplishment of the purposes of the federal scheme. *Florida Lime & Avocado Growers*, 373 U.S. at 142-43, 83 S.Ct. at 1217; *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S.Ct. 399, 404, 85 L.Ed. 581 (1941).

1. Compliance With Both State and Federal Regulations

The critical issue concerning order flow payments is the amount of disclosure required. Both federal and Minnesota law address disclosure requirements for securities transactions, although no state or federal law or regulation specifically addresses order flow payments. If Minn.Stat. § 80A.06, subd. 5 applies to order flow payments, it would appear to be stricter than the disclosure requirement in SEC Rule 10b-10(a)(7)(iii).

[3] A state regulation will survive a Supremacy Clause challenge where it is stricter than a federal regulation regarding the same conduct, so long as compliance with both is not impossible. *See, e.g., CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 84-87, 107 S.Ct. 1637, 1647-48, 95 L.Ed.2d 67 (1987) (state law which delayed consummation of tender offers until at least 50 days after commencement of the offer did not conflict with 20-day federal minimum period for holding open tender offers).

[4] In the present case, compliance with both state law, if applicable, and the SEC rule is not an impossibility. Compliance with Minn.Stat. § 80A.06, subd. 5 necessarily

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L.Ed.2d 348 (1973) ("Congress intended to subject the exchanges to state regulation that is not inconsistent with the federal Act").

satisfies SEC Rule 10b-10(a)(7)(iii). Thus, the laws are not conflicting. Moreover, the state legislature should be able to enact stricter laws protecting its citizens than federal laws, unless there is some overriding federal or national consideration.

In addition to their statutory claims, appellants allege common law causes of action based primarily on Minnesota agency law. Appellants assert that Schwab, as their fiduciary, owed them a duty of loyalty, a duty of full disclosure, and a duty of due care in executing their instructions. Under agency principles, appellants also assert that Schwab owed a duty to divulge the amount and source of remuneration it received in exchange for routing orders to certain wholesale dealers. Assuming appellants' common law claims are actionable, there are no federal laws that conflict with or would preclude the bringing of such claims.

Therefore, we conclude that compliance with both federal and state regulation is not an impossibility. But, this conclusion does not end our inquiry. State law may still be preempted if it stands as an obstacle to the accomplishment and execution of the full purpose and objectives of Congress.

2. Purpose and Objectives of Congress

Schwab argues that there is an actual conflict between the state and federal schemes because to give effect to Minnesota statutory and common law would be an obstacle to the accomplishment and execution of the full purpose and objectives of Congress. We disagree.

We reject Schwab's assertion that appellants are attempting to use Minnesota law to affect the operation of the national securities markets. A review of appellants' complaints reveals that appellants do not suggest that order flow payments themselves are illegal under Minnesota law or that they should be prohibited. Rather, the crux of appellants'

complaints is that order flow payments were retained by Schwab without any disclosure to or remuneration of Schwab's clients.

Schwab asserts that appellants are in fact seeking an end to order flow payments because the suggested disclosure requirements would effectively end the practice. We disagree. There is no credible evidence to suggest that more disclosure would end order flow payments. Requiring added disclosure in no way affects how the securities markets operate. Added disclosure could, however, benefit the investor. Thus, application of Minnesota law would serve a basic purpose of the federal laws and regulations. *See Zeller v. Bogue Elec. Mfg. Corp.*, 476 F.2d 795, 800 (2d Cir.) (Securities Exchange Act is "for the protection of investors"), *cert. denied*, 414 U.S. 908, 94 S.Ct. 217, 38 L.Ed.2d 146 (1973); *El Khadem v. Equity Sec. Corp.*, 494 F.2d 1224, 1227 (9th Cir.) (purpose of Act was to ensure "full and fair disclosure to purchasers of securities"), *cert. denied*, 419 U.S. 900, 95 S.Ct. 183, 42 L.Ed.2d 146 (1974).

We conclude therefore, that imposition of Minnesota law would not conflict with the congressionally-mandated goal of uniform and consistent regulation of the securities markets and would not frustrate the ongoing regulatory activities of the SEC.

Accordingly, we hold that there is no conflict between Minnesota common or statutory law and federal law concerning the regulation of order flow payments. Thus, an action challenging a securities brokerage firm's retention of order flow payments without adequate disclosure is not preempted by federal securities law or regulations. A state district court can therefore determine the merits of the dispute.

II. Primary Jurisdiction

The doctrine of primary jurisdiction is a judicially created doctrine concerned with the orderly and sensible coordination of the work of agencies and courts. *City of Rochester v. People's Coop. Power Ass'n*, 483 N.W.2d 477, 480 (Minn.1992). Its application is used whenever enforcement of the claim requires the resolution of issues that, under a regulatory scheme, have been placed within the special competence of an administrative body. *Id.*

[5] Use of the doctrine ensures that agencies are not passed over in cases raising issues of fact not within the conventional experience of judges or cases requiring the exercise of administrative discretion, so that uniformity and consistency result. *Id.* The doctrine is inapplicable if the issues raised are inherently judicial unless the legislature has explicitly granted exclusive jurisdiction to the administrative body. *Id.*

[6] Whether brokers must disclose or remit order flow payments to their customers under Minnesota law, on these undisputed facts, is a question of law. Therefore, resolution of these issues does not require the special fact- finding abilities of the SEC. *Cf. Ricci v. Chicago Mercantile Exch.*, 409 U.S. 289, 305, 93 S.Ct. 573, 582, 34 L.Ed.2d 525 (1973) (case raised issues of fact and questions about the scope, meaning and significance of Exchange membership rules, matters that " should be dealt with in the first instance by those especially familiar with the customs and practices of the industry and of the unique marketplace" involved in the case).

This case is distinguishable from *Gordon v. New York Stock Exch. Inc.*, 422 U.S. 659, 95 S.Ct. 2598, 45 L.Ed.2d 463 (1975). The SEC does not expressly regulate order flow payments as it does commissions. *See id.* at 685, 95 S.Ct. at 2612-13. While the SEC will impose regulation of order flow payments in the future, the fact remains that there are now no

specific regulations. Thus, order flow payments are not a matter exclusively within the province of the SEC and state regulation would not interfere with any SEC regulatory activity. The SEC is not expected to control every relationship in the securities industry nor is it empowered to. Accordingly, the doctrine of primary jurisdiction does not bar appellants from asserting their actions in the state district court.

DECISION

The district court erred in determining that appellants' Minnesota common law and statutory claims are preempted by federal securities law and regulations. Additionally, appellant's claims should not be deferred to the Securities and Exchange Commission under the primary jurisdiction doctrine.

Reversed and remanded.

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN FOURTH JUDICIAL DISTRICT

Kirk Dahl, on behalf of himself and all others similarly situated,

Plaintiffs,

vs.

Charles Schwab & Co., Inc.,

Defendant.

File No. 93-16272

ORDER

Robert Olson, on behalf of himself and all others similarly situated,

Plaintiffs,

vs.

Charles Schwab & Co., Inc.,

Defendant.

File No. 93-16360

Charles Dahl, on behalf of himself and all others similarly situated,

Plaintiffs,

vs.

Charles Schwab & Co., Inc.,

Defendant.

File No. 93-16383

The above-entitled matter came on before the undersigned, a Judge of District Court, on February 28, 1994, upon the motion of defendant for summary judgment.

Mark Reinhardt Esq., and Karl L. Cambronne, Esq., appeared on behalf of Plaintiffs. Norman J. Barry, Jr., Esq., and Jeannine L. Lee, Esq., appeared on behalf of Defendant.

Based upon all the files, records and proceedings herein,

IT IS HEREBY ORDERED:

1. That Defendant's motion for summary judgment is, in all respects, granted. The above-captioned cases are dismissed in their entirety.

2. That the attached Memorandum be made a part of this Order.

LET JUDGMENT BE ENTERED
ACCORDINGLY

BY THE COURT:

/s/ Robert H. Lynn
Judge of District Court

Dated: 4/7, 1994

MEMORANDUM

In each of these three companion cases plaintiffs claim to represent a class of Minnesota residents who purchased or sold stock through defendant Schwab. Plaintiffs allege that Schwab received a "kickback" from stock dealers completing the transactions in exchange for Schwab's routing the class member's transaction through the stock dealer. Plaintiffs claim that this practice was not disclosed to them in breach of Schwab's fiduciary duty to them. Plaintiffs seek money damages as well as injunctive relief.

Schwab characterizes these payments as "order flow payments", cash inducements paid to them in exchange for routing aggregate customer orders to specific wholesale firms. It is Schwab's position that this practice is accepted and widespread in the industry and is no different than other forms of inducements such as offers of discounts, credits and free services. It is undisputed that these practices are nationwide in scope and affect countless transactions each day involving investors throughout the country. It is also undisputed that this practice, while under scrutiny by the Securities and Exchange Commission (SEC), is permissible and lawful under the federal regulatory scheme.

Defendants now move for summary judgment based upon a variety of theories. MRCP 56 provides that summary judgment shall be granted when there are no genuine issues of material fact and either party is entitled to prevail as a matter of law. It is the opinion of this court that application of state law to the practices in question here, would violate the Supremacy Clause of the United States Constitution. Plaintiffs' lawsuit must, therefore, be dismissed.

The Supremacy Clause of Article VI of the Federal Constitution prevents the states from interfering with federal law and policy. *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 368, 106 S.Ct. 1890, 1898, 90 L.Ed.2d 369 (1986).

State law may be preempted "when it actually conflicts with federal law." *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 108 S.Ct. 1145, 1150, 99 L.Ed.2d 316 (1988). Securities transactions are subject to regulation under both federal and state law. Section 28(a) of the Securities and Exchange Act of 1934 (15 U.S.C. sec. 78bb(a)) specifically preserves the rights of the states to regulate securities transactions so long as that regulation does not conflict with the provisions of the Act or the rules and regulations under it. *Leroy v. Great Western United Corp.*, 443 U.S. 173, 182 99 S.Ct. 2710, 2715, 61 L.Ed.2d 464 (1979). A state law or regulation cannot take root if it looms as an obstacle to full achievement of the full purposes and ends which Congress itself has set out to accomplish. *Schneidewind*, 108 S.Ct. at 1151.

To the extent that the order flow payments are permissible under Federal regulations yet could be prohibited under the laws of Minnesota, a conflict exists. Consequently, it is the opinion of this Court that state preclusion of order flow payments would impermissibly disturb the federal SEC regulation of such practices and would frustrate the objectives of Congress as set forth in the SEC Act. The need for uniformity and consistency in the regulation of national securities markets is better facilitated by allowing the SEC to utilize its expertise in resolving the underlying issues.

The special expertise of the SEC over matters involving the fixing of rates and commissions charged by brokers was discussed at length by the United States Supreme Court in *Gordon v. New York Stock Exchange, Inc.*, 422 U.S. 659, 95 S.Ct. 2598 (1975). The plaintiffs in *Gordon* alleged federal antitrust violations relating to fixed rates of commission charged by brokers. The supreme Court concluded that under the Exchange Act, Congress intended to entrust the supervision of the fixing of reasonable commission rates to the SEC, and that "[i]nterposition of the antitrust laws, which

would bar fixed commission rates as *per se* violations of the Sherman Act, in the face of positive SEC action, would preclude and prevent the operation of the Exchange Act as intended by Congress and as effectuated through SEC regulatory activity." 422 U.S. at 691.

The *Gordon* decision arrived at this conclusion following a lengthy analysis of the history of the SEC. It was noted that since enaction of the Exchange Act of 1934, Congress gave clear authority to the SEC to supervise exchange self-regulation with respect to the "fixing of reasonable rates of commission." The Court noted that upon SEC determination that exchange practices regarding commission rates required change in order to protect investors or insure fair dealing, the SEC was authorized to require adoption of such changes as were deemed necessary or appropriate.

An analysis of *Gordon* reveals that the SEC has historically used its specialized expertise in studying and ultimately controlling the regulatory rate structure. Years of study culminated in 1975 with the SEC striking down the practice of fixed commission rates. Likewise, in the case at hand, it is undisputed that the SEC is closely monitoring the the practice of order flow payments. An SEC report released in October, 1993 indicates that disclosure requirements are under scrutiny and the SEC is inviting public comment. From the materials submitted to this Court it is apparent that the study has focused on the impact of this practice upon dealers, brokers, investors and the market as a whole. It is obvious that this practice has nationwide impact, the regulation of which is uniquely within the competence of the SEC.

The *Gordon* court ultimately concluded:

> Given the expertise of the SEC, the confidence the Congress has placed in the agency, and the active roles the SEC and the Congress have taken, *permitting courts throughout the country to conduct*

> *their own antitrust proceedings would conflict with the regulatory scheme authorized by Congress rather than supplement that scheme.* 422 U.S. at 621 (Emphasis Added)

Plaintiffs seek to distinguish *Gordon* on the basis that this decision dealt with federal antitrust law rather than state law. In this Court's view, the fact that the regulatory rules of the SEC relating to the fixing of commissions are immune from federal antitrust regulation provides an even stronger indication that the same regulatory rules should be immune from potentially conflicting state regulations.

The Minnesota Supreme Court very recently dealt with the Supremacy Clause in connection with the constitutionality of Minn. Stat. Sec. 179.12(9), the "Minnesota Striker Replacement Act". In essence, this statute prohibited employers from replacing striking workers with permanent workers. *Midwest Motor Express, Inc. v. International Brotherhood of Teamsters, Chauffeurs, Warehouseman and Helpers of America, Local 120*, (Finance and Commerce, March 11, 1994) held that Sec. 179.12 is preempted by the National Labor Relations Act and is thus unconstitutional. In so holding, the court stated:

> If, however, there is an imbalance in economic weaponry, it is not a regional problem to be addressed in whatever manner, or not at all as each state sees fit; it is a national problem which requires uniform treatment by Congress.

These considerations are, in this Court's opinion, equally applicable to the circumstances of this case. The court has been advised that identical litigation, challenging the order flow payment practice, is pending in at least one other state. For each state to render potentially conflicting rulings

regarding these practices would transform a uniform scheme of federal regulation into a shambles. This is precisely the reason for the existence of the Supremacy Clause. Accordingly, defendant's motion for summary judgment is granted and plaintiffs' complaints are, in all respects, dismissed.

RHL

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS

Robert Orman	)	
v.	)	NO. 93 CH 7365
Charles Schwab & Company	)	

ORDER

This cause coming on to be heard on motion of defendant to dismiss the complaint, due notice having been given, the parties having offered and argued the motion, it is hereby ordered:

That defendant's motion to dismiss be and is GRANTED, this court having determined that plaintiff's claims are preempted by federal law and having adopted the opinion of the District Court of Hennepin County, Minnesota in that complaint styled *Dahl v. Charles Schwab & Company*.

June 2, 1994

ENTER:

/s/
Judge

Not Reported in F.Supp.

(Cite as: 1995 WL 626522 (W.D.La.))

Robert C. THOMAS, On Behalf of Himself and a Class of all other Similarly Situated Schwab Customers

v.

CHARLES SCHWAB & CO., INC.

Civ.A. No. 95-0307.

United States District Court, W.D. Louisiana.

July 12, 1995.

Donald G. Kelly, Kelly Townsend & Thomas, Natchitoches, LA, Walter J. Leger, Jr., Leger & Mestayer, New Orleans, LA, Gilbert V. Andry, IV, Jonathan B. Andry, Andry & Andry, New Orleans, LA, Lionel H. Sutton, III, New Iberia, LA, William W. Goodell, Jr., Conlee S. Whiteley, Allan Kanner, Allan Kanner & Assoc, New Orleans, LA, for plaintiff.

Ewell E. Eagan, Jr., Donna P. Currault, Steven W. Copley, Gordon, Arata, McCollam & Duplantis, New Orleans, LA, for defendant.

RULING

LITTLE, District Judge.

*1 Plaintiff Robert Thomas filed suit against Charles Schwab & Co., Inc. ("Schwab") in the Tenth Judicial District Court for the Parish of Nachitoches, Louisiana, on 3 February 1995. The petition was amended on 13 February 1995 to add

plaintiff Robert Kahn, a resident of California, to the suit. On 22 February 1995, defendant Schwab removed this action to this court. Plaintiffs now move to remand this case to state court arguing that no subject matter jurisdiction exists.

This court must agree. As plaintiffs point out pursuant to 28 U.S.C. § 1332, complete diversity must exist at the time the petition for removal was filed. *In Re Carter*, 618 F.2d 1093, 1101 (5th Cir. 1980), *cert. denied*, 450 U.S. 949 (1981) (citing *Pullman Co. v. Jenkins*, 305 U.S. 534, 537-8 (1939)). In the case at hand, plaintiff Kahn and defendant Schwab are citizens of California and were parties to this suit prior to removal. Thus no diversity jurisdiction exists.

Defendant Schwab however asserts that despite the lack of diversity jurisdiction, this court has subject matter jurisdiction because a federal question has been presented. Generally the removability of a cause of action is determined by the allegations of the complaint. *Avitts v. Amoco Production Co.*, 53 F.3d 690, 693 (5th Cir. 1995). On the face of plaintiffs' complaint, this suit for breach of agency and fiduciary duties is not removable because no federal claims have been made.

Nevertheless, defendant Schwab claims that the plaintiffs are attempting to avoid federal jurisdiction by artfully pleading a federal cause of action in state law terms. Specifically defendant Schwab asserts that the Securities Exchange Commission (" SEC") regulations have completely preempted the regulation of order flow payments to brokers. Defendant states that the SEC has carefully studied the need for regulations governing a broker's disclosure obligations of order flow payments to its customers. As a result of this study, the SEC has balanced the interest of free and fair competition in the national market system and its obligations to protect the investor by amending Rule 10b- 10 and adopting Rule 11Ac1-3 of the Securities Exchange Act of 1934. The defendant contends that SEC's failure to require that disclosure of

specific information concerning the "amount of remuneration" and that "the remuneration was paid by a party whose interests are adverse to those of the customer" on each transaction slip demonstrates the fact that such regulation is unnecessary and any attempt to require such disclosure through state law would directly conflict with SEC's intentions.

As both parties have pointed out, there are three circumstances in which complete preemption occurs: First, when acting within constitutional limits, Congress is empowered to preempt state law by so stating in express terms. Second, congressional intent to preempt state law in a particular area may be inferred where the scheme of federal regulation is sufficiently comprehensive to make reasonable the inference that Congress "left no room" for supplementary state regulation .... As a third alternative, in those areas where Congress has not completely displaced state regulation, federal law may nonetheless preempt state law to the extent it actually conflicts with federal law. Such a conflict occurs either because "compliance with both federal and state regulations is a physical impossibility," or because the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. *2 *Perry v. Mercedes Benz of North America, Inc.*, 957 F.2d 1257, 1261 (5th Cir. 1992). Defendant states that complete preemption exists because "[p]laintiffs' effort to invoke state common law to regulate order flow payments -- especially where the SEC has expressly done so after long and deliberate study -- would prevent the SEC from discharging its responsibilities to Congress."

Congress has not expressly preempted state law and, after a review of the record, this court finds that congressional intent to preempt state law cannot be inferred. Much of defendant's arguments center around the issue of whether order flow payments to the broker should be permitted at all.

Defendant's references to SEC releases demonstrate that the agency does not find that brokers' acceptance of these payments should be precluded. Yet, despite these comments, the issue at hand is the extent of brokers' disclosure. Defendant admits that " SEC regulations authorize the receipt of payments for order flow if the broker discloses the acceptance of such payments when the account is opened, annually thereafter and on the transaction confirmation." This court finds that additional disclosure regarding " amount of remuneration" and that " the remuneration was paid by a party whose interests are adverse to those of the customer" will not conflict with this SEC regulation nor act as an obstacle to the protection of a fair competitive market and investor interests.

In addition, defendant has not persuaded this court that it was Congress' intent to provide comprehensive regulations dealing with the disclosure of order flow payments to the exclusion of all state laws regarding agency and fiduciary duties. Thus, this court finds that complete federal law preemption does not exist. We do not have subject matter jurisdiction. This case must be remanded.

Not Reported in F.Supp.

(Cite as: 1995 WL 262262 (E.D.La.))

Gordon DUMONT
v.
CHARLES SCHWAB & CO., INC.

Civ. A. No. 95-0606.

United States District Court,
E.D. Louisiana.

May 04, 1995.

CHARLES SCHWARTZ, J., District Judge.

*1 Before the Court are the following motions: (1) plaintiff Gordon Dumont's ("Dumont's") Motion to Remand; and (2) defendant Charles Schwab & Co., Inc.'s ("Schwab's") Motion to Dismiss, for Summary Judgment and/or to Stay/Transfer. The matter was set for hearing on May 3, 1995 but was deemed submitted on the briefs. For the reasons stated herein below, the Court GRANTS plaintiff's Motion to Remand, and thus does not reach of the merits of the defendant's Motion to Dismiss, etc.

BACKGROUND

Charles Schwab & Co., Inc. ("Schwab") is a discount securities brokerage firm. If a stock is traded on a national or regional stock exchange, a broker such as Schwab has several options on how to execute a client's securities transaction. One option is for Schwab to place an order through a wholesale dealer who makes a market in the traded security. Under this

practice, Schwab executes a buy order at the dealer's current ask price per share or executes a sell order at the dealer's bid price. The spread between the ask price and the bid price is the wholesale dealer's per share profit.

Dealers are often willing to return some of their spread, usually a few cents per share, in exchange for a brokerage firm's business. These dealer payments to brokerage firms such as Schwab have been termed in the securities industry as "order flow payments." Schwab does not remit the order flow payment to its client.

Schwab mails a confirmation slip after the client places an order. There is a limited disclosure on the reverse side of the confirmation slip to the effect that Schwab receives or may receive remuneration, other than commission for the order. The disclosure does not set out the amount of remuneration but provides that such amount will be disclosed upon the client's request.

Plaintiff Gordon Dumont ("Dumont") on behalf of himself and all others similarly situated, commenced an action in the Civil District Court for the Parish of Orleans, State of Louisiana, challenging Schwab's handling of order flow payments, based upon Schwab's alleged breach of Louisiana law. Dumont has alleged that he and other investors like himself have sustained losses based on Schwab's concealment of payments from wholesale brokers. Dumont claims that Schwab breached its duties under Louisiana law by (1) failing to adequately disclose its order flow payments, (2) failing to avoid self-dealing, and (3) failing to turn over to clients, like Dumont, the funds retained and received by Schwab for order flow payments. Plaintiff does not challenge the legality of order flow payments or whether such payments are permissible under Louisiana law. Rather, the gravamen of plaintiff's claims is that in violation of the stricter standard under Louisiana law, order flow payments were retained by Schwab without adequate disclosure and/or remuneration to

its clients. Noting that the purpose of the Securities Exchange Act is "for the protection of investors"[1] and to ensure "full and fair disclosure to purchasers of securities,"[2] plaintiff argues that Louisiana law does not conflict with federal regulations, and is in fact consistent with the Congressionally-mandated goal of uniform and consistent regulation of the securities market.

*2 Schwab argues that Louisiana law requiring fuller disclosure would effectively end the practice of order flow payments and would adversely effect how the securities market operates. Schwab has obviously misconstrued the gist of plaintiff's claim where it argues a decision prohibiting order flow payments based upon state law would impermissibly burden interstate commerce in violation of the commerce clause. Dumont does not seek injunctive relief to prohibit the practice of order flow payments nor does plaintiff claim that the practice is impermissible or in violation of Louisiana law.

Unquestionably, the order flow payment scheme has been the subject of much debate and the litigious enterprise. The parties have apprised the Court of much of the ongoing litigation filed by various classes against Schwab in and around the country involving the practice of "order flow payments."

Congress has passed no statute directly dealing with order flow payments. SEC Rule 10b10(a)(7) codified at 17 C.F.R. §240.10b-10(a)(7)(iii)(1994) which was in effect at the time the subject cause of action arose requires only that a broker send the client written notification disclosing whether any other remuneration has been or will be received and that the source and amount of such other remuneration will be furnished upon written request of such customer.

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[1] *Zeller v. Bogue Electric Manufacturing Corporation*, 476 F.2d 795, 800 (2nd Cir.), *cert. denied*, 414 U.S. 908 (1973).

[2] *El Khadem v. Equity Sec. Corp.*, 494 F.2d 1224, 1227 (9th Cir.), *cert. denied*, 419 U.S. 900 (1974).

On September 27, 1994, the Securities and Exchange Commission voted to amend Rule 10b-10 and adopt Rule 11Ac1-3 under the Securities Exchange Act of 1934 generally requiring enhanced disclosure of order flow payments. The SEC released its final rule on October 27, 1994 to be effective April 3, 1995. The new rule and amendments are designed to provide relevant information to customers regarding factors influencing the routing of their orders and serve to enhance investor protection and further competition for retail orders by enabling customers to evaluate more effectively the markets to which their orders are routed.

MOTION TO REMAND

The gravamen of plaintiff's motion to remand filed pursuant to 28 U.S.C. § 1447(c) is that there is no federal question, and the amount in controversy as to each class member, which amounts cannot be aggregated, is less than the jurisdictional threshold. Defendant Schwab contends that federal question jurisdiction exists since plaintiffs Louisiana law claims are completely preempted by the SEC's involvement in the area of securities law which entity has primary jurisdiction, violative of both the Supremacy Clause and the Commerce Clause of the United States Constitution, and in any event, plaintiffs' claims for monetary damages can be aggregated since plaintiff's suit is a "true class action" filed pursuant to Louisiana law and thus class members have a common undivided interest in the Fund of Order Flow Payments to Schwab.

In order to determine whether removal is proper the Court must necessarily delve into the issue of complete preemption, which is also at the heart of the defendant's motion to dismiss.

*3 To support removal, the defendant bears the burden of establishing federal jurisdiction over the state-court suit.

Carpenter v. Wichita Falls Independent School District, 44 F.3d 362, 365 (5th Cir. 1995). Moreover, because the effect of removal is to deprive the state court of an action properly before it, removal raises significant federalism concerns which mandate strict construction of the removal statute. *Merrell Dow Pharmaceuticals, Inc. v. Thompson*, 478 U.S. 804, 809, 106 S.Ct. 3229, 3233, 92 L.Ed.2d 650 (1986); *Willy v. Coastal Corp.*, 855 F.2d 1160, 1164 (5th Cir. 1988).

The defendant asserts the doctrine of complete preemption applies, and that because of preemption the state court must necessarily look to federal law in passing on Dumont's claims. A determination that a cause of action presents a federal question depends upon the allegations of the plaintiff's well-pleaded complaint. Generally, under section 1331, a suit arises under federal law if there appears on the face of the complaint some substantial, disputed question of federal law. *Franchise Tax Board v. Construction Laborers Vacation Trust*, 463 U.S. 1, 12, 103 S.Ct. 2841, 2848, 77 L.Ed.2d 420 (1983). Ignoring the petition for removal and its own pleadings, the defendant opposing remand must locate the basis of federal jurisdiction in the plaintiff's complaint. A defendant may not remove on the basis of an anticipated or even inevitable federal defense, but instead must show that a federal right is "an element, and an essential one, of the plaintiff's cause of action." *Gully v. First National Bank*, 299 U.S. 109, 111, 57 S.Ct. 96, 97, 81 L.Ed. 70 (1936).

A plaintiff with a choice between federal and state law claims may elect to proceed in state court on the exclusive basis of state law. *Merrell Dow Pharmaceuticals*, 106 S.Ct. at 3233 n.6. The Merrell Court stated that "jurisdiction may not be sustained on a theory the plaintiff has not advanced." *Id.*

Courts have recognized that although a defense, preemption may so forcibly and completely displace state law that the plaintiff's cause of action is either wholly federal or nothing at all. *Avco Corp. v. Aero Lodge No. 735, Int'l Assn.*

of Machinists, 390 U.S. 557, 559, 88 S.Ct. 1235, 1237, 20 L.Ed.2d 126 (1968). In *Carpenter v. Wichita Falls Independent School District*, 44 F.3d 362, 367 (5th Cir. 1995), the court noted that "the doctrine represents a narrow exception to the rule requiring the basis of federal question jurisdiction to be found on the face of plaintiff's well-pleaded complaint and not in any anticipated defense." *Id.* The Fifth Circuit in *Carpenter* commented: "So far as we are aware, the Supreme Court has clearly sanctioned the rule only in the area of federal labor relations law and the Employee Retirement Income Security Act of 1974 (ERISA), the latter on the basis of its legislative history references to the former." *Id.* at 367 n.2. The applicable law of the Fifth Circuit is absent extraordinary circumstances, such as where a federal cause of action completely preempts a state cause of action, the well pleaded complaint rule governs -- that is, if a plaintiff has a viable state law claim, he may depend on it alone and thereby defeat attempts at removal. *Id.*

*4 In the case at bar, Dumont's state court petition alleges violations of state law only. State law is displaced by federal law where (1) Congress expressly preempts state law; (2) Congressional intent to preempt is inferred from the existence of a pervasive regulatory scheme; or (3) state law conflicts with federal or interferes with the achievement of federal objectives. *Hodges v. Delta Airlines, Inc.*, 44 F.3d 334, 335 n.1 (5th Cir. 1995). Since 15 U.S.C. § 78bb(a) (Supp. 1994) specifically provides that "[t]he rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity," neither express preemption nor a pervasive federal regulatory scheme can be seriously argued.

The Supreme Court in *Leroy v. Great Western United Corporation*, 443 U.S. 173, 182, 99 S.Ct. 2710, 2716, 61 L.Ed.2d 464 (1979) noted that section 28 "was plainly intended to protect, rather than to limit, state authority." The

Supreme Court explained: Thomas Corcoran, a principal draftsman of the 1934 Act, indicated to Congress that the purpose of § 28(a) was to leave the States with as much leeway to regulate securities transactions as the Supremacy Clause would allow them in the absence of such provision. Hearings on S.Res. 84 (72d Cong.), 56, and 97 (73d Cong.) before the Senate Committee on Banking and Currency, 73d Cong., 1st Sess., 6577 (1934). In particular, the provision was designed to save the state blue-sky laws from preemption. *Id.* at n.13. *See also, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 94 S.Ct. 383, 394 (1973) (noting that "Congress, in the securities field, has not adopted a regulation system wholly apart and exclusive of state regulation."). The *Merrill Lynch* Court explained that "instead, Congress intended to subject the exchanges to state regulation that is not inconsistent with the federal Act." *Id.*

Where as here, Congress has not explicitly or implicitly displaced all state regulation in a specified field, preemption arises only if compliance with both federal and state law is an impossibility or when the state law is an obstacle to the accomplishment of the purposes of the federal scheme. Although applying the Louisiana standard of fiduciaries to a national brokerage company such as Schwab may require a stricter standard of care to its customers, the application of Louisiana law does not conflict with the SEC's authority and power to regulate the securities industry, and compliance with both federal regulations and the stricter Louisiana standard of care is not impossible. Moreover, since greater disclosure could benefit the investor, the application of Louisiana law may indeed serve the basic purpose of federal laws and regulations.

Schwab has failed to carry its burden of proof. The applicable authorities simply do not support complete preemption. Plaintiff has not asserted a claim under the federal law, argued any violation of federal law, and no federal

question exists although some analysis of federal law was necessary to determine whether there existed any conflict between the applicable state and federal rules and regulations.

*5 The Court now turns to defendant's argument that for diversity purposes, plaintiffs' claims can be aggregated to approximate the requisite jurisdictional amount. Schwab's contention is based upon (1) Louisiana law which it argues provides for a "true class action" and (2) that the order flow payments are an aggregate transaction based upon the volume of individual transactions.

Plaintiff argues in opposition that: (1) the Louisiana Code of Civil Procedure is not applicable when determining federal jurisdiction; (2) in any event LSA- C.C.P. Art. 591 does not automatically compel aggregation of all class actions; (3) comment (c) to Article 591 suggests that the federal practice of having three types of class actions--true, hybrid, and spurious--was based upon the federal need to establish permissive joinder devices and such is unnecessary in Louisiana state court proceedings because regardless of the diversity of parties jurisdiction is maintained in state court; and (4) plaintiffs' claims specifically look to the individual transaction on behalf of each class member, and whether Schwab receives such order flow payments as an aggregate or in individual increments is irrelevant.

Again the Court must refer to the well-pleaded complaint. The plaintiffs do not claim an undivided interest in a common fund. Rather, each plaintiff claims entitlement to reimbursement only for his or her due, based entirely upon their own individual stock purchases through the defendant Schwab. The fact that the order flow payment was in a lump sum is irrelevant -- each of the plaintiff's claims are separate and distinct and based upon their own individual stock transactions through Schwab.

The defendant argues earnestly that this is a "true class action" and that the plaintiff's claims should be aggregated to

obtain the jurisdictional amount in controversy. A painstaking reading of the cited authorities, however, reveals that they do not support defendant's contentions particularly considering the averments of the well-pleaded complaint.

Aggregation of individual claims to meet the jurisdictional amount is generally disallowed, however, a limited exception exists when two or more plaintiffs "united to enforce a single title or right in which they have a common and undivided interest." *Troy Bank v. G.A. Whitehead & Co.*, 222 U.S. 39, 40-41, 32 S.Ct. 9, 56 L.Ed. 81 (1911); *Association Nacional De Pescadores v. Dow Quimica*, 988 F.2d 559, 563 (5th Cir. 1993). Under Louisiana law, each of the similarly situated plaintiffs could assert on their own a claim for the violations alleged herein.

In *Eagle Star Ins. Co. v. Maltes*, 313 F.2d 778 (5th Cir. 1963), the Fifth Circuit explained that where class members interests are distinct, and their only relationship is that "they form a class of parties whose rights or liabilities arose out of the same transaction, or a relation to a common fund or mass or property sought to be administered, such distinct demands or liabilities cannot be aggregated...." *Id.* at 780. The allegation of a common fund or a lump sum payment is insufficient to support the aggregation of claims. The claims appear to this Court to be several -- if successful in prosecuting such claims, each plaintiff will only be entitled to reimbursement for his or her own claim and the quantum will depend entirely upon the amount of stock that each purchased through Schwab.

*6 Accordingly and for all of the above and foregoing reasons,

IT IS ORDERED that the plaintiff's Motion to Remand is hereby GRANTED.

The Clerk of Court is directed to remand this matter to the Civil District Court for the Parish of Orleans.

CIVIL DISTRICT COURT FOR THE
PARISH OF ORLEANS

STATE OF LOUISIANA

NO. 95-1527 DIVISION "L" DOCKET NO.

GORDON DUMONT

versus

CHARLES SCHWAB & CO., INC.

FILED: _____ _____
DEPUTY CLERK

ORDER

Came on for hearing this 16th day of June, 1995, defendant's Exception of No Cause of Action, and Alternatively Motion for Summary Judgment and plaintiff's Motion for Class Certification;

After hearing the arguments of counsel, and considering the pleadings and memoranda of counsel, and all applicable law and facts;

IT IS HEREBY ORDERED that defendant's exceptions are hereby denied.

IT IS FURTHER ORDERED that defendant's Motion for Summary Judgment is hereby denied;

IT IS FURTHER ORDERED that the following class of persons be and it is hereby certified as a plaintiff class in this matter pursuant to Louisiana Code of Civil Procedure:

All Louisiana residents who between February 1, 1985, and February 1, 1995, purchased or sold through Charles Schwab & Co., Inc. (hereinafter "Schwab"), wherein Schwab received monetary payments from a stock dealer or market maker through whom the transaction was routed, who did not expressly dispense with Schwab's obligation to provide a complete accounting and receipt of its retention of order flow payments.

IT IS FURTHER ORDERED that Gordon Dumont by and he is hereby found to be a proper and adequate class representative for the foregoing plaintiff class.

IT IS FURTHER ORDERED that the parties cooperate in an effort to devise an appropriate form of Class notice and to determine an appropriate method of disseminating said notice to the Class. The proposed notice and method of notifying the Class shall be submitted to the court for approval. If no agreement is reached, each party shall present to the Court his view on the matter of notice.

NEW ORLEANS, LOUISIANA, this 30th day of June, 1995.

/s/ Max N. Tobias, Jr.
DISTRICT JUDGE

TESTIMONY OF
ARTHUR LEVITT, CHAIRMAN
U.S. SECURITIES AND EXCHANGE COMMISSION

CONCERNING S. 1815,
THE "SECURITIES INVESTMENT PROMOTION ACT
OF 1996"

BEFORE THE COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

June 5, 1996

* * *

III. Significant Issues Raised by S. 1815

A. Rethinking the Federal-State Regulatory Partnership

Overview. Several provisions of S. 1815 would amend the federal securities laws to preempt state requirements in the areas of investment adviser regulation and the registration of specified securities offerings, including offerings by investment companies and offerings of nationally listed securities. The bill does not, however, preempt state regulation in the broker-dealer area.

The current system of dual federal-state regulation is not the system that Congress -- or the Commission -- would create today if we were designing a new system. While securities markets today are global, issuers and securities firms still must register many securities offerings in 52 separate jurisdictions; satisfy a multitude of separate books and records requirements; and bear the substantial costs of compliance

with the overlapping requirements. The current scheme of federal-state regulation is particularly onerous for investment companies, which are extensively regulated by the Commission, and whose business is fundamentally national in nature.

At the same time, however, state securities authorities play an essential role in the regulation of the U.S. securities industry. State regulators are often the front line of defense against developing problems; they are the "local cops" on the beat who can quickly detect and respond to violations of law. Further, the states have been aggressive in seeking to publicize instances of possible fraud and abuse as a means of better educating investors.

It appears that an appropriate balance can be attained in the federal-state arena that better allocates responsibilities, reduces compliance costs and facilitates capital formation, while continuing to provide for the protection of investors. The bill's approach to the division of responsibilities in the investment adviser and investment company areas exemplifies such a balance.

Additional Amendments Suggested for S. 1815. The Commission has endorsed H.R. 3005, which would preempt state law requirements, particularly in the areas of securities registration and broker-dealer regulation, that are not preempted in S. 1815. These other provisions also achieve the goals of regulatory simplification and protecting investors. While S. 1815 takes important steps in the right direction, a combination of the approaches in S. 1815 and H.R. 3005 would provide a more comprehensive rationalization of our federal-state system.

Securities Registration.

S. 1815 includes significant securities preemption provisions with respect to investment companies, and would codify existing state law exemptions for issuers whose securities are "nationally traded," that is, listed on the New York Stock Exchange, American Stock Exchange, or on the NASDAQ National Market System. However, other securities preemption provisions could be included that would enhance the utility of the securities preemption provisions without sacrificing investor protection.

For example, H.R. 3005 provides relief for smaller businesses that are not "nationally traded" by preempting federally registered offerings by companies that have two years of audited financial statements and at least $10 million in assets.

H.R. 3005 also provides helpful simplification by preempting state regulation of secondary market trading transactions, and of certain exempted securities (such as commercial paper) and municipal securities (except in the state where issued). Most of these transactions already are exempt in the states through differing formulations; codification of the exemptions could reduce "blue sky" expenses considerably.

The Commission supports these provisions and believes it would be worthwhile for the Committee to consider each of these provisions as possible additions to S. 1815.

Broker-Dealers.

S. 1815 would not preempt state involvement in broker-dealer regulation. The Commission has supported a

number of limited provisions in this area contained in H.R. 3005, which are worthy of the Committee's consideration.

As a general matter, the Commission recognizes that state regulators have a compelling interest in determining who may do business within their borders, and in how such business is conducted. The Commission also recognizes, however, that businesses trying to compete in today's changing financial world are hindered by the potentially conflicting requirements of 52 jurisdictions, and that, for this reason, securities firms have a compelling interest in a centralized and predictable regulatory system.

Balancing these two concerns, the Commission believes that states should continue to license broker-dealers that do business within their respective jurisdictions, and to receive fees for licensing such broker-dealers. States already have begun to create greater uniformity by developing a central registration depository system for broker-dealer registration.

The Commission also believes, however, that states should not impose books and records and capital requirements that exceed applicable SEC and SRO standards. H.R. 3005 would preempt state laws that impose books and records requirements, as well as financial responsibility and reporting requirements, that are inconsistent with or that exceed requirements established under the Exchange Act. The Commission supports state preemption in this area.

Broker-Dealer Margin.

In a related area, S. 1815 does not include amendments that appear in H.R. 3005 concerning margin requirements for broker-dealers. The Commission and representatives from the securities industry recommended these provisions, which

would remove legislative restrictions on the sources from which broker-dealers may obtain financing. These provisions also would exempt from the Federal Reserve Board's margin requirements the extension, maintenance or arrangement of credit for a broker-dealer or a member of a national securities exchange if (1) a substantial portion of the broker-dealer's or exchange member's business consists of transactions with persons other than broker-dealers or (2) such credit is used to finance the broker-dealer's or exchange member's securities activities as a market maker or underwriter. The Commission supports these margin changes.

* * *